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ABSTRACT

Financial planning and management responsibilities of college governing boards are examined. External factors and the institution's condition and direction of movement are addressed, along with policies concerning financial resources (e.g., tuition, financial aid, investments, and educational and auxiliary sales and services). Also considered are: (1) objects of expenditures, including personnel expenses, purchasing, capital outlays, and energy; (2) the management of capital, loan funds, endowment and plant funds, and long-term debt; and (3) the protection of resources through audits, risk management and insurance, patents and copyrights, and legal counsel. Finally, a basic system of reporting for the governing board is described, with illustrative formats for 18 reports. The basic reporting system is composed of the following: state of the institution, long-range plan and budgets, operating reports, results of operations, and external auditor's report. Appended are sample balance sheets, statement of changes in fund balances, a statement of current funds revenues and expenditures, a conflict of interest questionnaire, a glossary, and a bibliography. Each section of the guide includes a list of questions for trustees to consider. (SW)

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Financial Responsibilities of Governing Boards

of Colleges and Universities
Second Edition

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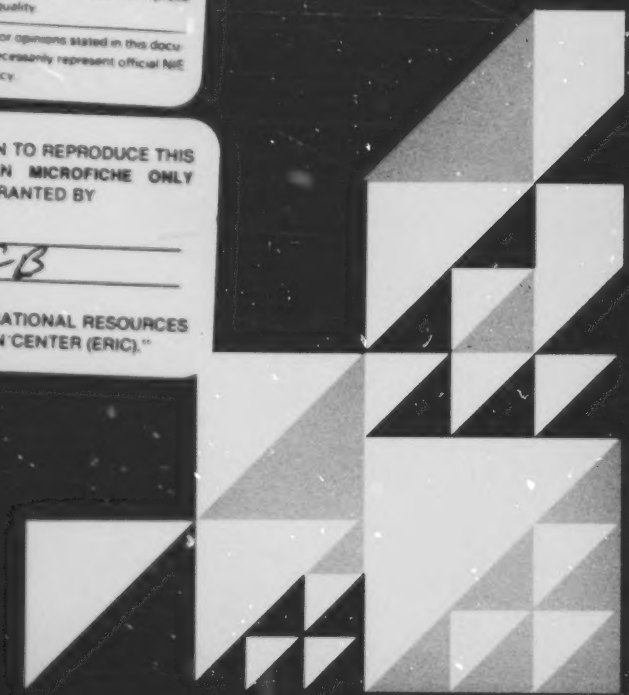

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Financial Responsibilities of Governing Boards

of Colleges
and Universities

Second edition supported through the generosity of
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Foreword to the Second Edition

The first edition of this volume was published in 1979, and we are pleased that countless trustees, presidents, and business officers have found it useful. In fact sales have been so brisk as to warrant a second printing. Instead of simply reprinting, however, it was recommended that this monograph be revised to reflect the current state of higher education institutions in 1985 and to make some predictions for the years ahead. Thus a new committee was formed to provide guidance for those portions of this monograph that required revision. The new committee is named in Acknowledgments to the Second Edition.

Although some affiliations have changed in the five years since this volume was published, we thought it appropriate to retain the original list of Steering Committee members with their positions held in 1979, pilot test institutions, and funding sources. Accordingly, this information can be found in the Foreword to the First Edition and Acknowledgments to the First Edition, respectively.

The first edition of *Financial Responsibilities* has proven helpful to many institutions. We hope the same will be true for this edition as well.

Robert L. Gale
President
Association of Governing Boards
of Universities and Colleges

Robert L. Carr
Executive Vice President
National Association of College
and University Business Officers

Foreword to the First Edition

This monograph was developed over a period of more than two years by a joint steering committee of the Association of Governing Boards and the National Association of College and University Business Officers. The steering committee was composed of three trustees, three presidents, and three business officers, whose names appear in the acknowledgments.

Eight pilot test institutions participated in the project; their boards and administrators evaluated an early draft of the monograph and reviewed the concepts and principles described therein with respect to financial information from their own institutions. These steps were important in refining the monograph. More than five hundred copies of a subsequent draft were sent for review to trustees, presidents, and business officers from many types of colleges and universities; the comments received resulted in substantial improvement in the final version.

The boards of directors of the two associations have approved this monograph for publication. They recommend it to their members and to all others interested in the financial information needs of governing boards. However, implementation will require careful consideration, evaluation, and adaptation to each institution's particular needs. It is recognized that there is no single approach suitable for all institutions or even for one kind of institution, but it is stressed that the concepts and principles emphasized in this monograph and the suggested approach for financial reporting will serve as helpful guides.

The associations hereby commend the steering committee members for their extraordinary involvement in this project.

Robert L. Gale
President
Association of Governing Boards
of Universities and Colleges

D. F. Finn
Executive Vice President
National Association of College
and University Business Officers

Acknowledgments for the Second Edition

The second edition of *Financial Responsibilities* was sponsored by a grant from Coopers & Lybrand's Higher Education Industry Group, for whose generosity we are grateful. The Association of Governing Boards (AGB) and the National Association of College and University Business Officers (NACUBO) are especially indebted to Wallace E. Ackley, Senior Consulting Partner for Education, Coopers & Lybrand, for his support and perseverance.

The new manuscript was developed and prepared by a talented cadre of persons whose diligence and dedication never wavered, including:

Wallace E. Ackley, Senior Consulting Partner for Higher Education, Coopers & Lybrand

John B. Cox, Director of Communications, NACUBO

D. F. Finn, Senior Vice President, NACUBO

Carol Frances, Chief Economic Advisor, National Education Industry Group, Coopers & Lybrand

James A. Hyatt, Director, Financial Management Center, NACUBO

John W. Pocock, Chairperson, Board of Trustees, College of Wooster, and honorary member of AGB Board of Directors

We especially commend Bill Pocock for his outstanding contribution to this publication.

We also wish to acknowledge: Roslyn Stewart Christian, Director of Special Projects and Assistant to the President, AGB, for coordinating the project; Anna Marie Cirino, Research Associate, Financial Management Center, NACUBO, for revising the various charts and graphs; and Leonard A. Johnson for his inspired design.

Acknowledgments for the First Edition

This monograph was made possible by a grant from the W. K. Kellogg Foundation of Battle Creek, Michigan. The Association of Governing Boards and the National Association of College and University Business Officers are especially grateful to Dr. Peter R. Ellis, program officer of the foundation, for his strong and abiding interest in the project from proposal to publication.

The steering committee was composed of three trustees, three presidents, and three business officers, but the committee was much more than the name implies. The members worked for two years in planning the project, reviewing several drafts and hundreds of comments, and making recommendations for revision. This monograph is the result of their dedication. The members:

John W. Pocock, Chairperson of the Board of Trustees, The College of Wooster, Chairperson

James F. Brinkerhoff, Vice President and Chief Financial Officer, The University of Michigan

Merrill A. Ewing, Treasurer and Business Manager, Mount Holyoke College

Darrell Holmes, President, East Stroudsburg State College

Elmer Jagow, President, Hiram College

Robert E. Lahti, President, Community College of Denver

Mary Louise Petersen, President, Iowa State Board of Regents

Frank Smathers, Jr., Trustee, University of Miami

William M. Wilkinson, Director of Finance, The University of Rochester

Coopers & Lybrand, certified public accountants, provided substantial funds as well as a group of consultants headed by Wallace E. Ackley. The consultants undertook the initial research, helped to organize the monograph, and offered guidance to the directors and steering committee at each stage of the process.

Codirectors of the project were Nancy R. Axelrod of AGB and K. Scott Hughes of NACUBO. They managed the project, coordinated the several reviews, and revised the various drafts. Their role was far greater than that of directors only.

Also to be acknowledged are Douglas J. Collier of the National Center for Higher Education Management Systems, who served as a consultant to the project and who wrote much of Chapter 1; Abbott Wainwright of NACUBO, who edited the final manuscript for publication; and Marlise Mason, who designed the monograph.

One of the most important contributions was participation of the governing boards of eight pilot test colleges and universities, without which the practices recommended in the monograph could not have been tested. These institutions are listed below with their liaison officers, who devoted many hours to this project.

The University of Alabama, David W. Phipps
California Lutheran College, A. Dean Buchanan
Dallas County Community College District, Walter L. Pike
University of Delaware, J. Robert Harrison
Indiana University of Pennsylvania, George W. Murdoch
Lawrence University, Marwin O. Wrolstad
University of Miami, John L. Green, Jr.
Ohio Wesleyan University, Robert W. Meyer

Although unnamed here, over two hundred reviewers provided comments on the various drafts of this monograph. Their participation, which is hereby acknowledged, was essential to the success of the project.

Preface

Financial pressures affect almost every aspect of an institution's programs. Each program action taken is related to the institution's finances, and the availability of financial resources is a dominant factor in setting institutional priorities. Although there are some differences in the governance process between public and independent institutions, the governing board carries the ultimate authority and responsibility to guide the destiny of the institution, including the assurance of continued financial viability.

The proficiency with which members of governing boards exercise this stewardship depends critically on their understanding of the financial affairs of the institution and on how effectively significant financial information is communicated to them. But the apparatus for communicating such information in a manner to enhance their decision making appears to need some improvement.

Inquiries directed to the Association of Governing Boards frequently come from trustees and regents who have difficulty in interpreting the financial information presented to them. Trustees without a background in finance (and, traditionally, not included on finance committees) acknowledge embarrassment in asking questions that reflect this inexperience, yet they recognize their responsibility to participate intelligently in financial decisions. Even board members with financial experience in other fields often question the peculiarities of college and university finance.

This concern of board members has not gone unrecognized. Several attempts have been made by public accounting firms and individual colleges and universities to change the manner in which financial information is communicated to the board. Useful notions have been developed but, by and large, the suggestions center on technical adjustments in the manner in which financial information is conveyed rather than on the management decision needs of boards. As a body, the trustees and regents have yet to be heard from; this monograph approaches the information problem from their point of view.

The reader should be aware of two major thrusts. First, the monograph is directed to members of governing boards. Although procedures and reports are suggested, the basic objective is to trace in clear and simple terms the dynamic, continuous flow of financial resources through the programs of the

institution. This flow moves from the acquisition of funds through allocation of operation expenditure to the protection and enhancement of the institution's capital. The attempt to reduce the presentation to basic concepts and terms will inevitably bring charges of oversimplification from the financially astute practitioners; their indulgence is requested on behalf of the less experienced trustee. Second, the monograph stresses the use of financial accounting information for managerial rather than fiduciary purposes. Relevance of financial outcomes to program decisions is noted. Policy items relating to financial decisions are stressed. Ways are suggested to use the information for analyzing performance in achieving objectives, and some key financial indicators are proposed. The position is taken that administrative officers have an obligation to communicate financial information continually to the board to permit trustees and regents to monitor intelligently the financial status and progress of the institution and its programs.

The monograph includes other aspects of the board's obligations only as they relate to financial consequences. It is designed as a reference manual useful both to board members and to institutional officers who provide information to the board.

The Policy Level

It is worth repeated emphasis that this monograph deals with the responsibilities of the trustee operating at the policy level. Little specific knowledge of the detail of institutional accounting is required, nor does the trustee have a need for such knowledge. It is thus by no means a text on institutional accounting and financial analysis. For those who have an interest in the intricacies of such accounting there are many useful publications institutional financial officers can suggest. But it should be noted that the partially educated "trustee-accountant" risks losing sight of central financial patterns in the pursuit of detailed figures and accounts.

The real task of the trustee is to be able to relate the financial status and requirements of the institution to the programs and functions linked to the financial capacity and to grasp the varying impacts of such support on the programs of the institution. Identifying such linkages is a major objective of this monograph. In generating, spending, and conserving resources, allocation and flow of dollars are but a reflection of the programs and priorities of the institution as established or endorsed by the trustees. This is trustee decision making at the policy level.

To exercise such judgment the trustee requires information. While such information is partially available in the accounting reports, these reports are

designed primarily for other purposes. Thus a new and different type of reporting to the trustees might be in order. The nature of such reports is suggested by examples in this monograph. With the introduction of such reports to the board, the information process moves beyond the accounting arena to an integration of program and financial information essential to the exercise of the financial responsibilities of governing boards.

Caveats and Limitations

Any attempt to portray the complex financial activities of a college or university and the interactive role of the governing board is necessarily ambitious. A major limitation is the extreme diversity of institutions. This monograph does not categorize many characteristics that make institutions different from each other, but some of the major institutional differences that will affect adaptation of the material in this monograph are listed below.

Public/Independent. While governing boards of independent institutions are the ultimate decision makers, boards of public institutions may be accountable to a combination of state boards, commissions, the budget office, and the legislature. However, it is generally a responsibility of the board of a public institution to reconcile, integrate, and implement the policies of these agencies; that is, the board should be the managerial center for the agencies. (Although it is recognized that governing boards of public institutions might not have the degree of control boards of independent institutions have, this monograph refers to boards as if they all had ultimate control.)

Level of Involvement. The monograph assumes that a governing board, when addressing financial issues, is concerned primarily with (1) approving the institution's mission, goals, and policies, (2) reviewing institutional activity, and (3) evaluating institutional performance with respect to objectives. However, there are institutions — notably, many community colleges — where the board takes a more active and detailed approach to its responsibilities as overseer. The degree of involvement a governing board has with the management of the institution will determine the kind of financial information it requires.

Governing Board Organization. Design of the board's financial information system depends on the size of the board, committee organization, and frequency of board meetings. Each board, with the administration, should determine its financial information requirements using the guidelines contained in this monograph.

Importance of Specific Financial Issues. The mission of an institution is often a guide in determining what financial information is most important

for its governing board. The relative importance of each financial issue might vary over time; certain issues might not change for many years, while others, such as tuition and admissions, might always require attention.

Internal Management and Financial Information. Because the monograph focuses on financial information for governing boards, there is little mention of the organization of financial information required by the administration for routine internal operations or of the data-gathering systems institutions use to prepare the financial reports. Information used by the board comes from several sources, such as the president and his or her staff, chief academic officer, chief business officer, student affairs officer, development officer, registrar, and so on. Implementing a comprehensive system to gather the information required by the board will take time; a team approach is thus recommended for efficiency with respect to both time and overlapping responsibilities.

Standards

While the monograph recommends standards of good practice such as establishing policies and having a long-range plan, no attempt has been made to establish performance norms. The monograph does suggest that the exchange of financial information with similar institutions can often serve as a substitute, if not an improvement, for any attempts to establish normative standards of performance. Such an exchange must be implemented with great caution, and the differences in institutions must be considered. There is no single standard of financial performance due to the uniqueness of each institution.

Hybrid University and Other Examples

The monograph contains financial and statistical data related to a fictitious Hybrid University. The data are generally consistent throughout, so the reader should be able to develop an understanding of the financial strengths and weaknesses of Hybrid University. The source of financial data is Chapter 5:7, Illustrative Exhibits, of NACUBO's *College & University Business Administration* (1982), reproduced herein under the same title immediately following Chapter 6, Implementation.

Use of the Monograph

It should be stressed that in trying to encompass *all* types of institutions, this monograph naturally raises more questions than need to be asked about a *specific* institution. Because the scope of potential issues is so broad, trustees

are cautioned that all the "Suggested Questions" highlighted in the monograph do not need to be asked of, and indeed cannot be answered by, the management of a specific institution. Rather, issues facing the institution must be placed in order of priority.

Trustees should be sure the questions they raise are not related to issues that would be "nice to know" for their institution, but are those that would have a significant effect if the information were available for decision making. Business officers reading this monograph might be overwhelmed at the potential questions trustees might raise and might be reluctant to encourage trustees to give full attention to careful deliberation of the issues, concerns, and questions raised in the monograph — not through unwillingness to be responsive, but because of the potential burden of preparing responses by an already overworked staff.

There is no easy answer to the needs of trustees, on the one hand, and the ability of the institution to respond economically, on the other. It is hoped that this monograph will serve as a reference point for discussion among trustees, the president, academic officers, and business officers to enable them together to direct their attention more effectively to major issues facing their institution and to develop economical ways to provide information useful for decision making.

Suggested reports have been designed at an elementary level, as there is no single model of reports that could be used by all institutions; reports should be designed to fit the needs and available information of the particular institution.

This monograph will have been a success if it encourages open, frank discussion among the trustees, president, and other administrators. It is urged that administrators be aggressive in encouraging trustees to study this monograph, but trustees are cautioned to be moderate and conservative in imposing demands on the institution without understanding the costs and value of providing the information.

Introduction

One purpose of this monograph is to suggest how financial information should be presented to the governing board. Instrumental to the presentation of such information is an efficient communication system, which ultimately depends on the relationship between the board and the institution. The key persons in this relationship are the chairperson of the finance committee (if there is one), and the president and the chief business officer of the institution. Close cooperation among these persons is essential for financial information to flow freely in both directions.

The monograph stresses the importance of a clear statement of board organization and of how the board should function. The organization of the institution should also be clearly defined and the authority and responsibilities delegated to the president should be well documented. The officers of each major unit, usually vice presidents, should have an understanding of their roles and responsibilities with regard to the board as a whole and to its committees.

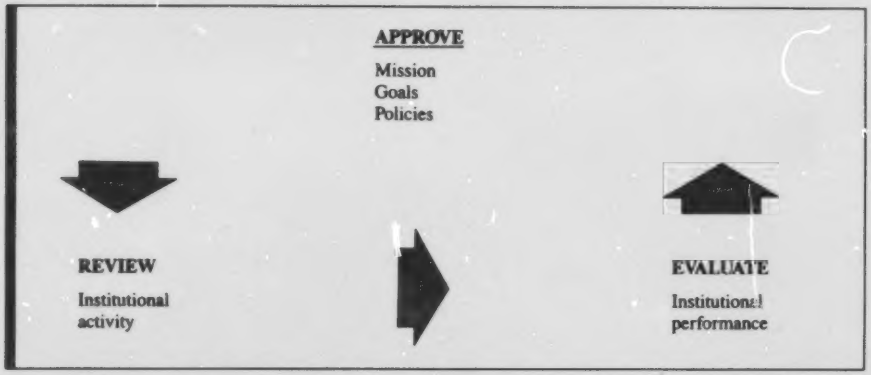
How the board is organized is less important than having clearly defined responsibilities for board members and having a board dedicated to the academic and financial success of the institution. The board must rely on the president to initiate the management process, but because of its position the board has the ability to provide the following:

- **Strong leadership.** Since the board typically has ultimate responsibility for the financial well-being of the institution, it is in a position to encourage establishment of sound financial management systems.
- **Different perspectives.** Governing board members have broad and diverse knowledge of many kinds of organizations; such knowledge affords valuable perspectives for colleges and universities.
- **Resources for the future.** Because the board is insulated from routine operations, it can focus on the future of the institution. One of its primary responsibilities is to make decisions and to take actions that will protect and enhance the institution's resources for the use of future students; this requires delicately balancing resources between the present and the future.

The approach used in this monograph for describing how a governing board oversees the institution's affairs is illustrated in the accompanying figure.

This approach involves board responsibility at three levels of the management process:

1. **Approving** institutional mission, goals, and policies.
2. **Reviewing** institutional activity.
3. **Evaluating** institutional performance in meeting objectives.



To carry out these functions effectively, the governing board requires different kinds of information and should devote different amounts of time to each. Primary attention should be directed to reviewing and approving mission, goals, and policies. With clearly defined objectives, review and evaluation can focus on major problems requiring less time.

Kinds of Financial Information

The way financial information is presented to the governing board depends on the purpose of the information and on what action the board is required to take. For example, such information can range from a routine report on new gifts received to a complex presentation of the long-range plan, involving many participants, visual aids, and long discussion.

Financial information can be separated into three broad categories:

- **Routine and periodic financial reports.** Communication for this purpose is generally in one direction: from the institution to the governing board. It could include reports on gifts received, new faculty appointments, and single purchases above a given dollar amount. The board is generally asked to ratify these matters, and little discussion is required.
- **Presentations requiring board discussion.** Communication in this case involves active participation of both parties. The administration makes a presentation, with recommendations to the board, for eliciting the board's

judgment and ultimately its approval. Such matters as policy formulation, long-range planning, budgeting, and purchase and sale of real property require this type of exchange.

- **Background reports.** As will be mentioned in Chapter 1, the board should be given reports describing the environment in which the institution operates. Such reports are for information only, and no action is expected to be taken on them; their purpose is to provide background material for decisions to be made at subsequent board meetings. This kind of information addresses the need for the board to examine and understand change, and thus to help the institution adjust to changes in the environment. It does not focus on any particular function, such as budgeting, or on any operating unit. Rather, it is provided because the board should be kept informed of events that might affect the institution and thereby its finances. The information presented might indicate trends that would lead the board to ask for more details. A corollary purpose of this kind of information is to prevent the board from being surprised when events occur that require a change in plans or operations.

The governing board and the institution's officers have the combined responsibility of designing a communication system that groups financial information in a manner that meets the board's needs. This can be accomplished by jointly identifying those subjects requiring only routine reporting and those focusing on more complex issues requiring the judgment and approval of the board.

Context and Consequences of Financial Information

When the governing board makes judgments on issues and ultimately approves policies, plans, and budgets, the financial information provided for these purposes is critical. If presented properly, such information will be illuminating and helpful; if presented poorly, it can be boring and sterile, or complex and confusing. The problem, of course, is what constitutes "proper" presentation. Boards should be given the context of the information, with a clear statement of the prospects, as well as the information itself. Some examples are presented below; in each the second alternative is preferable to the first.

Alternative 1: Tuition income for this quarter is $1.2 million.

Alternative 2: Tuition income for this quarter is $1.2 million, down two percent from a year ago, but in accordance with the budget. However, tuition from entering freshmen is five percent less than estimated, which was offset by a 10 percent increase in tuition from transfer students. The decrease in the number of entering freshmen is of concern and is being analyzed by the dean of admissions.

Alternative 1: Investment performance matches the goal for the fiscal year.

Alternative 2: Although investment performance matches the goal for the fiscal year, there are disturbing indications that the recent rise in interest rates might have an adverse effect on the institution's investment in common stocks.

Governing boards, when given the *context* of the data and any related prospects, will be more effective and will respond more quickly to recommendations of the administrators. Some factors appropriate for placing an issue in its proper context and describing the consequences might be:

1. Time span. Context: What has happened over time? (Example: Continual increases in tuition.) Consequences: What effect has this caused? (Example: Continual need for more student-aid funds.)

2. Policies and goals. Context: How does the issue relate to existing policies and goals? (Example: Decrease in the expected return on endowment compared to the amount budgeted.) Consequences: What effect does the issue have on the institution's policies and goals? (Example: The amount budgeted for endowment income must be decreased, which increases the estimated deficit.)

3. Environmental factors. Context: How does the issue relate to external conditions? (Example: Implementation of energy-saving measures to partially offset increase in energy costs.)

Presentation of Financial Information

Whether the subject is a routine report of federal grants and contracts received or a complex issue such as approving the operating budget, governing boards should be provided with financial information that focuses on critical issues in a manner that is logical, clear, and concise. There should be continual awareness of not overburdening the board with information. For smooth and effective communication, there are three rules for administrators to follow in presenting financial information to the board. These are:

- **Focus on the issue.** There should be no ambiguity about why a subject is being discussed. Board members should know if they are being asked to approve, review, or evaluate the subject.
- **Include the context and consequences.** (The previous section discussed the importance of this rule.)
- **Present the information in a logical sequence.** The presentation of financial information should begin at the governing board's point of reference

and should bring the board step-by-step to the point at which a decision can be made. A traditional approach used for effective presentation is:

a. Statement of the problem.
b. Background information.
c. Statement of approach to the problem, and assumptions used.
d. Description of form of analysis used.
e. Description of feasible decision alternatives and their consequences.
f. Recommendation and justification for the alternative chosen.

The amount of time spent on each part of the presentation depends on the complexity of material and the level of familiarity the board has with the issue. For example, the board (or investment committee) might be very familiar with the subject of investment policy, so the presentation of that subject could be brief. However, other subjects such as facilities planning, new academic programs, and setting tuition might require more time on background, assumptions, and description of the analysis, involving both visual aids and lengthy presentations.

Board Meeting and the Agenda

The board meeting is the forum in which members of the board officially assume their roles as overseers of the institution and legally act in that capacity. For the board to be effective, the meeting should be well planned and actively managed. There are several ways to help assure an effective board meeting. One of the most critical items is the agenda; its preparation can mean success or failure for a board meeting. A well-planned agenda can be a catalyst to crisp action; conversely, a poorly conceived agenda can cause confusion, frustration, and inactivity.

The following will help to assure effective presentations:

1. There must be adequate time to prepare the agenda. Administrators should develop a schedule that allows adequate time for preparing agenda items. This includes staff time for data accumulation, analysis, documentation, report presentation, and internal review and approval. Agenda items not subjected to this rigorous process are susceptible to poor presentation and unanticipated questions from board members. Particularly complex issues could require that the institution's officers prepare very carefully if effective presentations are to be assured. The chairperson of the board and chairpersons of its committees should also be fully briefed in advance of the meeting.

2. Only major issues should be presented. The board meeting should be planned to minimize the routine and to focus on critical issues. The agenda

should be organized so that only major items are given priority at the board level.

3. The agenda should be distributed in advance. The agenda and supporting documentation should be received by the board at least a week before the meeting. It is especially important that financial reports be received well in advance. To the greatest extent possible, items not on the agenda should be prohibited from being presented at the meeting; it is usually better to defer an item to the next meeting than to present it with no warning.

4. Resource persons should be used. Institutional officers and consultants can often enrich board presentations and should be used to full advantage. Although the president must be the leader, he or she can often effectively delegate presentations or refer specific questions to resource persons.

As the issues presented to the board have become more complex, some boards have established ad hoc committees for certain subjects such as review of the operating budget, long-range planning, and debt financing. The ad hoc committee meets with the institution's management team for a detailed discussion of the issues. Such sessions are rewarding to both the board members, who become more knowledgeable, and the institution's officers, who receive a different perspective on key issues. When the issue comes to the full board, ad hoc committee members can contribute much to the discussion.

Another key ingredient for successful board meetings is an understanding on the part of the academic administration of the financial issues facing the college or university. Such an understanding can be accomplished only through close teamwork by the academic and financial adminstrators. Board presentations that have the full participation of both academic and financial administrators will be more complete and will more likely reflect the overall goals of the institution.

Cycle of Financial Reporting to the Board

Issues taken to the board in a logical sequence and related to previous and future issues will give the board a further awareness of the time span and frame of reference for the decisions at hand. For example, the planning and budgeting process is continuous. This means the sequence for establishing the plan, adopting a budget, and continually reviewing performance in meeting objectives should be well defined, with a clear understanding of the specific issues to be brought to each board meeting.

The governing board and the institution's administrators should jointly develop a calendar of decision issues that lists items to be presented to the

board. Such a calendar provides continuity and stability, but administrators must balance the routine with the nonroutine. Not all issues to be presented fit neatly into a planning calendar; the board and administrators should establish a management approach that can respond in a timely manner to issues of immediacy. Even in urgent cases, care must be taken that the decision issue has been well defined and analyzed, with only well-considered recommendations presented.

Chapter 1

Context for Financial Planning and Management

As part of the context in which financial decisions are made, governing boards often discuss such issues as the institution's financial strength and stability, a changing student clientele, collective bargaining, demands for accountability, and inflationary pressures. However, it is important that they understand how these issues interact in their effects on the institution and that they consider these effects as part of the planning and management process.

The following questions are addressed in this chapter:

- What is the institution's current overall condition, and is the institution moving in a desirable direction?
- What factors in the external environment might affect the institution?

Both questions should be examined in their relation to the mission. In regarding the two questions, one assumes that the governing board should know the answers prior to conducting the long-range planning and budgeting process. Therefore, this chapter might be viewed as describing the framework for a "state of the institution" report. Such a report would be prepared on an annual basis and would provide an up-to-date context for both planning and budgeting decisions (see Report No. 1 in Chapter 6). It would include (1) an assessment of the current overall condition of the institution and the direction in which it is moving, with particular emphasis on how the past year's operations affected that direction, and (2) a list of environmental factors expected to have (or that are now having) significant effects on the institution.

Overall Condition and Institutional Direction

Ideally, every college and university moves in a direction consonant with its mission. Each time the institution accepts a new class of freshmen, the kinds of students it accepts have a significant effect on what the institution is and where it is going for at least the next four years. (For example: Do the students require financial aid? Are they academically strong or weak?) Hiring faculty members and granting tenure can affect the institution for many years into the future.

It has been argued that no one person or governing board actually changes

an institution. Rather, the board and the president, with the participation of the faculty, lead the institution in the direction it should go as decisions regarding change are made. Perhaps the most obvious way to lead an institution is to decide where, and in what ways, changes are to be made in programs and personnel. But even in a more or less steady state, decisions (not necessarily changes) are made every day that affect institutional direction. Colleges and universities inevitably change, and the direction of that change is a legitimate concern of the board.

To analyze overall condition and institutional direction, this chapter focuses on more than financial data. The assumption is made that it is just as important to know that the "demand" for the institution's services remains strong (or, from the institution's perspective, that it has sufficient "drawing power") as it is to know that the balance sheet reflects a better financial condition each year. The following factors may be used to analyze condition and direction of movement:

1. Drawing power
2. Structured learning environment
3. Nonclassroom learning environment
4. Financial strength
5. Outcomes

Drawing Power

In a college or university, as in any enterprise, it is important that the demand for its services be strong if it is to remain in good overall condition. In considering overall condition and direction of institutional movement, the concept of "drawing power" will be used to connote the institution's perspective regarding the demand for its services. The board is responsible for generating attractiveness through diversity of programs and other means.

Drawing power may be defined as the ability of the institution to attract a desired market for its educational services, for donor support, and for a superior faculty. It includes the ability to attract the kinds of students it considers itself to be serving and to provide the kinds of research and public services for which it has the capabilities. When one considers drawing power, the focus should be on ability to attract the *kinds* of students, research projects, and public service programs the institution desires as well as the *number* of students, research projects, and so forth. Or in a more active sense, drawing power suggests the ability of the institution to "sell" its services in the quantity, and at the price, it desires.

For assessing *overall condition*, drawing power can be viewed as a

measure of the institution's potential for attracting revenues. In certain kinds of institutions, it can also be seen as a concept parallel to selectivity, that is, the ability of the institution to be selective about the types of students it chooses to admit, the types of faculty it chooses to hire, and the types of programs it decides to conduct. While student selectivity obviously means little for institutions having open admissions, for those institutions that desire to be selective, a change in their ability to be selective can be regarded as a measure of change in their drawing power.

Drawing power can have a significant effect on the type and amount of financial resources the institution has available for use; for example, it affects the number of students paying full tuition, the number and kinds of grants the institution receives, and the willingness of donors to make gifts. Drawing power also affects other aspects of overall condition such as the financial *flexibility* (is the institution attracting revenues that can be used for several different purposes?), financial *independence* (what is the "mix" of sources of revenue the institution is attracting?), and financial *risk profile* (what is the certainty of funding associated with the various sources of revenue?).

For assessing *institutional direction*, drawing power can be related to the types of students and research projects or public service programs the institution is attracting. For example, changes in characteristics of students entering the institution will affect its direction of movement. One of the decisions institutions make that affect their ability to draw students involves admissions criteria (or in the case of open admissions, the existence of an "open" criterion). For example, if an institution decides to change significantly its entrance requirements, a different kind of student will be drawn to the institution and its direction of movement will change. Another change related to drawing power might not even involve an explicit decision; for example, if the

Suggested Questions

1. How many applicants have to be accepted to enroll one student? How has this ratio changed over the last few years? (See Report No. 1 in Chapter 6.)
2. How many students are applying to the institution this year compared with previous years?
3. How many students remain from one year to the next, e.g., from freshman to sophomore, and how does this compare with previous years? (See Report No. 1 in Chapter 6).
4. How many research proposals are submitted by the faculty for each grant received? How has this ratio changed over the last few years?
5. What kinds of research and public service projects are being undertaken now compared with five years ago?
6. Is it difficult to attract well-qualified faculty members?
7. Is donor interest being maintained?

institution begins serving for the first time a significantly large number of part-time students through evening classes and nontraditional programs, the direction of movement is affected.

Structured Learning Environment

A second element of the institution's overall condition is the quality of its structured learning environment, which for this analysis is defined to include the set of conditions that facilitates or impedes the ability of students to learn as part of a structured learning process. In this chapter it is hypothesized that the "quality" of a student's educational experience is a product of, and the interaction between, the institution's structured learning environment and its nonclassroom learning environment. The proposed "state of the institution" report mentioned earlier asks the governing board to assess the quality of these two environments separately as a proxy for assessing the quality of the educational experience provided by the institution. (The nonclassroom learning environment is discussed in the next section.)

Suggested Questions

1. Have recent accreditation reviews of the institution's departments resulted in any recommendations for significant changes? If so, what kinds of changes were recommended? Have they been or are they being implemented? If not, why not?
2. What are the percentage distributions of faculty within the various departments by tenure and nontenure?
3. How adequate are the library resources in providing support for the various departments? How adequate are other support items (media, computer, facilities, staff) for each of the departments?
4. Do the institution's various departments have particular areas or specialties in which they have a national or regional reputation?
5. What are the number and nature of awards and honors that have been received by students, faculty, and staff? How do they compare with those of past years?
6. Have turnover rates of faculty and staff changed significantly over the last five years? What has been the student attrition or dropout rate for the institution as a whole and for its departments?
7. Is the compensation of faculty and staff competitive?
8. How have faculty been rated on the student evaluation survey? How does this rating compare to ratings of past years?
9. Is the faculty represented by a union or are unionization efforts underway? Are demands outlined in union proposals more or less consistent with the institution's goals and objectives than they were in the past?

In assessing the structured learning environment as part of the analysis of *overall condition*, the governing board should ascertain the existence or absence of a collegial atmosphere between faculty and the administration, the quality of the faculty, and the availability of educational support staff and other

supporting resources such as equipment and library resources. In assessing the structured learning environment as it relates to *institutional direction*, the same factors would be considered, but the focus would be on the *changes* that have occurred in each area over time.

Nonclassroom Learning Environment

Another important contributor to the student's learning experience in most institutions (at least in those providing some type of learning experience outside the classroom) is the nonclassroom learning environment, which for purposes of this analysis may be defined as the set of conditions that facilitates or impedes the ability of students to learn from others as well as to educate themselves *outside the classroom.* As such, it includes the aggregate of social, cultural, and living conditions to which the student is exposed. It can be characterized by social and cultural diversity of the student body, diversity and type of living arrangements available to students, environment created by physical surroundings of the campus, and number and range of organized social and cultural opportunities available — for example, concerts, athletic events, theatrical productions, and guest lectures.

In assessing the nonclassroom learning environment as part of the analysis of *overall condition*, the governing board should consider (1) the existence of opportunities (or lack of them) for learning outside the classroom as well as the range of such opportunities available to students, (2) condition of the physical plant (whether it is being adequately maintained or is deteriorating),

Suggested Questions

1. Is the student body sufficiently diverse (e.g., in its social and cultural characteristics) to promote the kinds of nonclassroom learning experiences the institution desires? Has the diversity of the student body changed significantly over the past five years?

2. Are annual expenditures for maintenance and renovation of the physical plant sufficient to keep the buildings and grounds adequately maintained? Has the level of those expenditures kept up with plant additions, obsolescence, and inflation in the last five years?

3. What kinds of organized nonclassroom learning experiences (e.g., concerts, guest speakers, social events) are currently being provided? What is the level of financial support for such activities? Has either the level of financial support or the number and type of such activities changed significantly in the last five years? Are there adequate facilities for the activities? Are there opportunities for volunteer experiences in the community?

(3) relevance of the physical plant for the kinds of educational programs the institution is providing, and (4) the extent to which the social and cultural diversity of the students is consistent with the institution's mission.

In assessing the nonclassroom learning environment as part of the analysis of *institutional direction*, the board should check to see if there have been any

significant changes in these same factors over time.

Financial Strength

The fourth aspect to be considered in overall condition and institutional direction is financial strength. While colleges and universities are not in the business of "making money" as their primary objective, they must nevertheless have money to operate.

In higher education it is important, at least for independent institutions, for revenues to exceed expenditures in some years; the remaining revenues can be used to carry the institution through years in which expenditures exceed revenues (see Report Nos. 16 and 18 in Chapter 6). Providing for the future from excess revenues generated in present operations is such an integral part of the financing strategy of most independent institutions that it can be viewed as one criterion for evaluating financial strength. If an institution is unable year after year to save some portion of current revenues for future working capital and plant needs, it will soon have no reserves to draw upon when needed.

There are essentially three questions regarding this aspect of the institution's operations:

1. Is the institution living within its means on a year-to-year basis?
2. Are the institution's various sources of revenue stable?
3. Is the institution providing itself with financial resources it can draw upon to support future operations?

In addition to assessing *operations*, a financial analysis should consider the institution's *assets*. In analyzing assets one should give attention to (1) the adequacy of those assets relative to the amount and type of assets needed to carry out the institution's programs and (2) the flexibility with which those assets can be employed should financial difficulties arise. (See Report No. 15 in Chapter 6.)

Suggested Questions

1. Have the net changes in fund balances been positive? (See Report Nos. 16 and 18 in Chapter 6.)
2. At what level, and with what certainty, will the institution's primary sources of financial support continue to provide funds in the future?
3. Has the institution been able to set aside unrestricted revenues to serve as quasi-endowment funds? What is the current amount of such funds? (See Report Nos. 16 and 18 in Chapter 6.)
4. What percentage of the institution's assets can be liquidated and expended should the need arise? What problems would be encountered in doing so? (See Unrestricted Fund Balances in Report No. 15 in Chapter 6.)

Outcomes

The final element in the governing board's consideration of overall condition and institutional direction involves assessment of the "outcomes" of the institution. A major outcome of colleges and universities is the educated student; unfortunately, this outcome cannot be measured directly.

Outcomes are probably more relevant to institutional direction than to overall condition. For example, if such outcome indicators as average scores on the Graduate Record Examination (GRE) for graduating seniors or the percentage of graduates obtaining employment changes significantly over time, the board would want to study in more detail what is happening. (Some would say GRE scores are an indicator of the quality of the instruction program. However, in the context of this monograph, GRE scores would be considered only as an indicator of institutional direction.) Information about outcomes is usually not collected routinely by institutions because it is difficult to do; tangible indicators are few and subjective judgments are often biased. To obtain such information as the percentage of graduates obtaining employment or education, it will often be necessary to survey graduating students.

Suggested Questions

1. Has the percentage of graduates either obtaining employment or continuing their education changed significantly in the last five years?
2. How has the percentage of students who complete their programs in the normal time changed in the last five years?
3. In the case of community colleges, how many students transfer to senior institutions?
4. How have the Graduate Record Examination scores of graduating seniors changed by majors over the last five years?

External Influences

In addition to considering overall condition and institutional direction, a second topic to be considered in establishing the context for planning and management relates to the effect of the external environment on the institution. Current environmental factors affecting colleges and universities include uncertain economic conditions, more demands for institutional accountability, national and regional decline of traditional-age students, newly evolving patterns for older nontraditional students, government regulations and reporting requirements, declining government financial support and uneven financial support from all sources.

Most governing boards are aware of these external factors, which should be understood in the context of opportunities as well as constraints. The external constraints on the institution's actions are obvious, such as legal requirements and limits of financial support available, but boards should not

overlook the *needs* and *opportunities* within the environment that the institution can exploit.

For most colleges and universities, needs are met and opportunities are provided through three primary programs: instruction, research, and public service. Needs and opportunities can be viewed in a framework of those programs, namely, needs and opportunities related to instructional programs (which the institution currently provides or has the capability to develop), to research capabilities and interests of the faculty, and to public service programs the institution conducts.

With respect to external conditions, an institution might find that a changing student clientele could result in declining enrollments of traditional students while it also creates opportunities for providing instructional programs on weekends or at night to nontraditional students; for example, retraining, licensing, certification, and other nondegree activities are increasingly required in a complex society.

Suggested Questions

1. What are peer institutions or other institutions in the same geographic area doing about new programs, changes in tuition, and new methods of providing services (such as courses on weekends) that might significantly affect the ability of the institution to attract students?
2. How have the prices of major cost items changed — for example, faculty and staff salaries, library books, equipment, and energy — and what effect will those changes have on the institution's total budget?
3. Have there been any developments that would significantly affect the nature of the institution's traditional sources of revenue or the level of support they would provide — for example, the mood of the legislature regarding appropriations for education, feasible limits on student tuition, expected performance of investments, and gift projections?
4. Are students, at the national level, enrolling in the kinds of instructional programs offered by the institution? If not, in what kinds of programs are they enrolling?
5. What are the projected financial-aid needs of the kinds of students who enroll in the institution?
6. Has any legislation, either state or federal, been proposed or passed recently that will have a significant effect on the institution? What are the financial implications of that legislation?
7. What steps is the institution taking to promote interinstitutional cooperation?

Environmental constraints affecting the institution's freedom of action are competitive, economic, and legal. Decisions concerning the institution's pricing strategy, that is, the relation between tuition and financial aid, could be constrained both by competitive forces, such as the tuition of comparable nearby institutions, and by economic forces such as faculty salaries. Therefore, as part of the context for decision making, the board should understand both the opportunities and constraints placed on those decisions by the environment.

While the governing board needs to be aware of competitive forces, it is also important that it recognize the opportunities that exist for interinstitutional cooperation, particularly to the extent that such cooperation results in sharing resources or avoiding program duplication. In an environment characterized by increasingly scarce resources, it is essential that cooperation be as important a guiding principle as competition.

Chapter 2

Generating Financial Resources

Colleges and universities typically rely on a variety of sources for financial support. Students pay for the cost of tuition, room, and board; government agencies provide substantial subsidies and buy services; private sources make contributions and also buy services; the institution's own funds provide investment earnings; and the general public might pay for such services as patient care or for attending athletic events (see the accompanying table). Some revenue sources, such as tuition, can usually be used at the discretion of the institution, while others can be used only for purposes stated by the provider.

Source	Type of Revenue	Received Through
Students	Tuition and fees	Charge to consumer
	Room and board payments	Charge to consumer
Governmental sources (federal, state, and local)	Appropriations	Subsidy
	Grants and contracts	Reimbursement for services
Private sources	Gifts, grants, and contracts	Contribution or reimbursement for services
Institutional sources	Investment earnings	Investment of working capital and permanent funds
Sales and services	Educational activities	Charge to consumer
	Auxiliary enterprise activities	Charge to consumer

This diversity of financial resources requires a cohesive financing strategy and the development of administrative policies for providing management control in fulfilling the institution's mission. The governing board has responsibility for approving the financing strategy and administrative policies.

The various revenue sources and their amounts are affected in part by the institution's mission, its form of governance, and its administrative policies. For example, publicly supported research universities rely heavily on appropriations from state legislatures and on federal grants and contracts, while small, independent colleges derive most of their revenue primarily from tuition, private giving, and endowment earnings. Each institution's governing

board should understand the limits of its various revenue sources. In addition, the board should be aware of the flexibility and degree of management control associated with each source of revenue.

This chapter examines each of the potential sources of funds listed in the accompanying table and describes the policy issues governing boards should consider. Chapter 5 describes the planning and budgeting concepts that can be used to blend the revenue sources into a financial strategy.

Students

To the student, total cost of attendance, rather than tuition or any other component, is the key figure. In setting the charge for tuition, room, board, and laboratory and student activity fees, the governing board should be aware that these must be determined in relation to each other. (Some residential colleges do have a comprehensive fee, but each component is nevertheless known to the board and administration.) The total amount billed and the rates of increase for each item are sensitive economic and political issues that governing boards must consider.

Tuition and Fee Rates

The tuition rate is established in a political environment; this needs to be understood by the board. Students, parents, alumni/ae, faculty, taxpayers, and legislators have a vested interest in the tuition level. The governing board and administrative officers have the responsibility to explain the need for a tuition increase and to justify it in terms of academic program and economic considerations.

The board typically has the responsibility for approving tuition and fees, which are based on a combination of factors, including:

1. Balancing the budget. Tuition might depend on the amount needed to finance operating expenditures.

2. Historical precedence. Particularly in public institutions, there may be a political or historical basis for the relative tuition level. In this case, tuition for public institutions might be determined by the level of appropriations the legislature or other government body will provide.

3. Market conditions. A factor in determining the tuition rate is the amount charged by similar institutions. The governing board will want to be assured it is not *undercharging* or *overcharging* the tuition cost to students.

4. Relation to economic conditions. The annual increase in tuition can be tied to the rate of increase in personal disposable income or to an index measuring inflation. The rate of increase in tuition at independent institutions is generally related to the rate of increase in cost of instruction (salaries).

These factors impose the limits for increasing tuition. Public institutions might experience larger tuition increases if legislative pressures, tax reductions, inflation, or any combination of these reduce relative government appropriations, but all colleges and universities face the pressures of additional inflation, new programs, regulatory requirements, and limitations on other financial resources, which tend to increase tuition or reduce services.

Activity fees are for special purposes, and are used to cover specific costs such as student health insurance and social and athletic programs. The amount assessed generally is directly related to the cost of the activity. (Room and board payments as sources of revenue are included in the section on sales and services.) Some fees collected by the institution are dedicated for purposes such as debt service; others are collected on behalf of student organizations.

In addition to tuition and fee rates as factors affecting the actual or net revenues from tuition and fees paid by students, there are two others: student financial aid and admissions and retention rates. These are discussed below.

Suggested Questions

1. In public institutions, how does determination of the tuition rate relate to the appropriation process?
2. How does the total cost of attendance at this institution compare with costs of peer institutions?
3. How have increases in the total cost of attendance compared to increases in personal disposable income and inflation?
4. Is the institution relying more heavily on tuition as a percentage of total revenues?
5. What portion of the stated tuition income is offset by funded scholarships and grants? What is the proportion of funded aid to grant aid? What is the net tuition income and how has it varied against stated tuition over time? Is scholarship and grant aid appropriately packaged with loans and work?
6. Is there control over special purpose activity fees?

Student Financial Aid

Financial aid to students can be in the form of grants (such as scholarships, fellowships, and tuition and fee waivers), employment, and loans. Such aid can be provided by government agencies, gifts from donors, institutional loan funds, or directly from unrestricted current funds (sometimes referred to as "unfunded financial aid"). Also, aid might be provided directly to the student and not administered by the institution, such as state aid programs for students attending institutions within that state.

One of the critical management issues facing academic institutions and of concern to governing boards is funding of student financial aid. As tuition and room and board rates increase, so does the need for more financial aid. For example, when the board approves a tuition increase of $100, it should

realize that a certain amount, say $25, will be needed to finance increased financial-aid obligations. Only the remaining amount is available to meet inflationary pressures and the need for new programs.

The concept of financial aid being used to leverage tuition payments is not well understood. Stated simply, one segment of the student population pays the full tuition, another receives a subsidy (financial aid) that is paid from external sources such as governments and donors, and a third group (which typically overlaps the second) receives a discount financed from the institution's own funds.

Obviously, the relative size of each group has a significant effect on the tuition increase. For example, an institution having 80 percent of its financial aid provided by external sources, or by endowment funds restricted for scholarships, will benefit greatly from increased tuition rates, while an institution that provides 80 percent of its financial aid from its own funds will find it financially difficult to increase tuition rates and provide for the resulting financial aid needs.

In most cases, student financial aid is based on need. However, many institutions consider other factors such as academic achievement, vocational objectives, athletic ability, and leadership potential. Prudent allocation of financial aid also assists in developing the desired diversity of students and in maintaining access to the institution.

Suggested Questions

1. What is the composition of the institution's financial aid by source and by type (grant, loan, employment)? How has the composition changed over time?
2. What is the relationship of financial aid requirements to a student budget (tuition, room and board, and other expenses)? How has this changed over time?
3. How do financial aid expenditures of peer institutions compare to those of this institution? How has this changed over time?
4. To what extent are the institution's unrestricted funds being used for financial aid? What is the percentage of tuition? What is the rate for peer institutions?
5. What is the distribution of financial aid by sex, ethnic origin, age, economic background, and how has this changed?
6. Are there possible changes in federal or state programs that will affect the availability of financial aid?
7. What percentage of students is receiving financial aid and how has this changed? (See Report No. 5, Part A, in Chapter 6.)

Broad policies defining the objectives of the financial aid program should be recommended by the adminstration and approved by the governing board. These could be based on recommendations of a committee of representatives from academic departments, admissions and financial aid offices, student per-

sonnel office, business office, and student body. Such a financial aid committee should determine, in areas of its concern, standards and requirements relating to academic and other qualifications of applicants as well as methods used to evaluate their financial needs. The board should be aware of these standards and should approve the policies for administering financial aid.

Admission and Retention Rates

The third factor affecting tuition and fee revenues is the institution's admission and retention rates. The admissions level generally is measured in terms of applications received, acceptances issued, and actual matriculation. For example, an institution might receive 1,600 applications, admit 1,000 prospective students, and have 500 matriculate. The governing board should monitor closely these figures and relate them to those of previous years. Many public institutions having open admissions and extensive transfers might not be affected nearly as much by these factors for purposes of establishing tuition, but will be affected by the total number of students enrolled, compared with previous years.

In addition to examining the admissions figures, the governing board should be cognizant of the quality and diversity of the entering freshman class and how they compare with the quality and diversity of classes in previous years and with the institution's goals. Again, institutions having open enrollments might not be affected nearly as much by these factors. Board members should be aware of and should have approved the policy for admissions, which includes such factors as:

- Number of places available
- Ratio of in-state to out-of-state admissions
- Equality of access
- Affirmative action
- Admission criteria for entering freshmen, graduate students, and transfers
- Level of academic admissibility
- Evaluation criteria, such as high school grade average, class rank, test scores, and extracurricular activities

The governing board should also be aware of how student preferences compare to the academic offerings of the institution and if there has been any noticeable change. In addition, the board should have an understanding of why students admitted to the institution but who declined acceptance chose another institution. The causes for not matriculating could point out

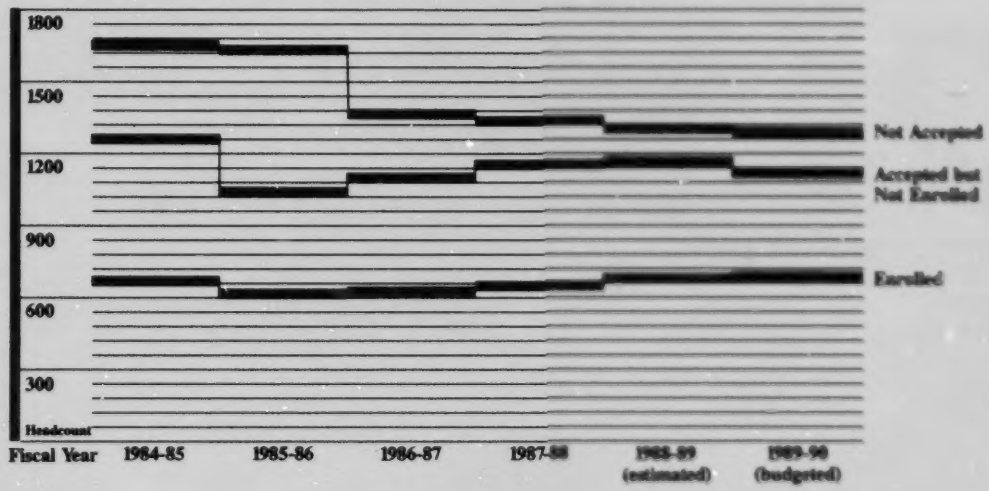
weaknesses in the institution's academic offerings or other factors requiring examination.

The retention rate reflects the percentage of students remaining at the institution from year to year, and is another factor governing boards should examine (see Report No. 4 in Chapter 6). Significant changes in the retention rate could be due to changing student preferences, changing economic, political, or social conditions, or changing conditions on campus. In addition to having an effect on revenue, changing retention rates can be a sign of problems requiring administrative examination.

Suggested Questions

1. What are the application, acceptance, and matriculation figures for the entering freshman class, and how have they changed over time? (See Report No. 4 in Chapter 6.)
2. What is the mix — by ethnic origin, sex, class rank, family income, Scholastic Aptitude Test (SAT) score, etc. — of the entering class, and how has it changed over time?
3. What are the reasons potential students have chosen other institutions and how have these changed over time?
4. What are the institution's retention factors, and how have they changed over time? (See Report No. 4 in Chapter 6.)
5. What are the application, acceptance, and matriculation figures for transfer students by level and program, and how have they changed over time?

Student Application, Acceptance, and Enrollment
at Hybrid University



Government Sources

Each institution varies in its sources and levels of government support. The sources of such support can be classified as appropriations (federal, state, and local) and grants and contracts (federal, state, and local).

Appropriations

The appropriations process varies by jurisdiction and is related to requirements of the respective government authority. However, there are some basic reminders for every college or university.

First, the institution should have the expertise to communicate effectively with its respective government agencies. This expertise is in many forms, and effective communication requires persons who can express the institution's programmatic and financial needs.

Second, the institution should have an organizational structure that enhances its ability to communicate effectively with the agencies. Members of the governing board and designated institutional officers should be responsible for communicating directly with the agencies as required. Specifically for public institutions, the board must assume an advocacy role in presenting the institution's case to the legislature; this is one of its financial responsibilities.

Third, governing board members and officers of the institution should develop a spirit of cooperation with government authorities while at the same time maintaining the institution's autonomy. Often difficult to accomplish and to sustain, this effort requires sensitivity and understanding of the role and responsibility of the government authorities. The board should also have an understanding of the government authorities' priorities for higher education and a sensitivity to the political environment.

Suggested Questions

1. Has the priority of higher education changed for the government authority? (Including financial-aid programs.)
2. What percentage of the government authority's budget is for higher education, and how has it changed over time?
3. How does the institution's government appropriation compare with appropriations for other similar institutions?

Grants and Contracts

An institution enters into grants and contracts when it is to the mutual benefit of the sponsor and the institution to undertake a specific work objective. In contrast to an appropriation, which typically is a funding authorization of a general nature, grants and contracts are generally legal arrangements that define a specific project to be conducted for a specific amount of money.

Research projects, public service activities, institutes, and workshops are typical examples of this type of funding.

The governing board should help to establish and approve policies on grants and contracts, and the level of sponsored activity in relation to that of other activity should be reviewed by the board periodically. That is, the board should be aware of the institution's reliance on revenue from grants and contracts, and on a concentration of principal investigators, if such exists. Grants and contracts are generally of short duration (one to three years) and cannot be relied on to continue in the same sense as tuition or appropriations. The board should understand the consequences of major shifts in sources and interests of funding agencies on the total operations of the institution.

Although the revenue from grants and contracts increases total revenues to the institution, the additional accounting, recordkeeping, and reporting requirements of each funding agency must be considered, as they increase administrative and support costs. Federal grants and contracts are subject to changes in the method of reimbursing indirect costs. This has been and continues to be a major problem between universities and the government; it stems primarily from the fact that joint products — teaching and research — are involved. Because they are so intertwined, calculation of the indirect cost rate is a complex procedure.

Suggested Questions

1. Does the institution have adequate policies with regard to personnel administration, patents, copyrights, and rights of privacy to comply with legal obligations accepted under certain grants and contracts?
2. Does the institution have a stated policy on the kinds of research and public service activities to be undertaken and funded by grants and contracts?
3. To what extent are salaries of tenured faculty being funded from grants and contracts?
4. What is the outlook for the future funding of grants and contracts?
5. How has the institution fared with government audits?
6. To what extent are funding agencies fully reimbursing direct and indirect costs incurred on their projects?

Federal grants and contracts are also forces for social progress, as their provisions regulate employment and other practices. Colleges and universities are employers, and many are federal contractors, with the responsibilities that these terms carry. Thus, in accepting grants and contracts, institutions also accept their provisions such as (1) special reporting of policies and practices for patents and copyrights, and (2) promoting equity in employment, advancement, admissions, and other areas.

Private Sources

Money received by colleges and universities from private sources comes from either charitable contributions or grants and contracts. Charitable contributions are usually received as a result of solicitation by members of the governing board, certain administrators, professional staff, and alumni/ae volunteers. Grants and contracts entered into with private sources are generally initiated by the faculty, although some of these may be the result of fund raising by professional staff.

Traditionally, independent institutions have emphasized fund raising from private sources, but rising costs have forced more public institutions into fund-raising activities. Conversely, economic factors have forced independent institutions to apply to the state for funds (principally, capital and student financial aid).

The governing board should have a thorough understanding of the relative importance of funds received from private sources and, when needed, should become actively involved in solicitation. The more an institution must rely on gifts, the more attention it should devote to fund raising, policy formulation, long-range planning, and review of performance.

Suggested Questions

1. Does the institution have a policy describing the kinds of support it can accept from private sources?
2. How has support from private sources changed over time? Has it kept pace with inflation? How has it compared with other revenue sources? What are the prospects for the future?
3. How is support from private sources being used? Do certain programs rely heavily on the receipt of gifts and grants?
4. How do the institution's fund-raising activities compare with those of peer institutions?
5. What is the overall strategy for raising revenues from private sources? Is there need for a major fund-raising campaign?
6. What effects will anticipated changes in tax laws have on gift giving? Is the institution doing anything about them, such as communicating its concern to legislators?

The governing board should approve policies governing the kinds of gifts that can be accepted, and such a policy should also include criteria for rejecting gifts, such as those having unacceptable or illegal restrictions or those whose costs of administration would be excessive. It should also have an understanding of the institution's fund raising strategy and goals. Money from private sources can come from board members, alumni/ae, friends, corporations, and foundations (see Report No. 8 in Chapter 6). Gifts can be in many

forms, including pledges, bequests, and annuity and life income funds. They can be annual, ongoing gifts as well as large, one-time capital gifts.

The various forms of giving are affected differently by economic conditions, tax laws, socio-political influences, and the institution's fund-raising efforts. For example, large capital gifts are influenced by stock market conditions, whereas corporate giving is more strongly influenced by pretax profits. Board members should be aware of the different kinds of support received from private sources and should have a basic understanding of how that support can be affected by varying conditions.

Institutional Sources

Investment earnings are generated by the various "fund groups" of the institution, including current, loan, endowment and similar, life income and annuity, and plant. The current, or operating, fund would generally be invested for the short term, while the other funds typically would be invested for longer periods. Use of the earnings might be restricted or unrestricted; for example, earnings of restricted student loan funds may be used only for student loans.

The cash flow requirements, risk levels, restrictions on investment, and investment objectives vary for each kind of financial resource. Since the governing board has stewardship responsibility for all resources, members should have an understanding of the kinds of financial resources available for investment and should approve policies, establishing objectives for investment and its management. Institutions with large endowments must devote much time and money to actively investing their endowment portfolio.

Suggested Questions

1. Does the institution have investment policies that cover all of its financial resources?
2. Have investment performance objectives been established? Do they consider such factors as existing and forecasted economic conditions, anticipated payout rates, preservation of endowment purchasing power, acceptable level of risk, and portfolio mix? Should the total return concept be adopted (for spending levels)?
3. Do the investment managers have a clear understanding of their authority and responsibility?
4. Has investment performance met expectations? How does performance compare with that of peer institutions and with nationally recognized indices over an extended period?
5. Does the investment policy describe the institution's social responsibility with regard to investments?

When determining investment objectives, the governing board should have an understanding of such economic factors as inflation, interest rates, and the national economy, as these affect performance. The board has responsibility

for the appointment of investment managers and may delegate full discretionary powers to the managers, or the institution itself may handle the investments. The board should also approve, for each type of fund being invested, the expected investment objectives, desired level of risk, term of investment, portfolio mix, and investment performance. Whatever method of managing investments is adopted, the board has the responsibility for investment performance.

Sales and Services

Revenues from sales and services can cover a broad range of activities. Some of these are:

Sales and Services of Educational Activities

- Film rentals
- Testing services
- Home economics cafeteria
- Demonstration schools
- Dairy creameries
- College theaters

Sales and Services of Auxiliary Enterprises

- Residence halls
- Faculty housing
- Food services
- College unions
- College stores
- Intercollegiate athletics

Sales and Services of Hospitals

- Daily patient services
- Nursing services
- Other professional services
- Outpatient services

Services provided by such activities assist in creating the educational environment, and in some instances are a required ingredient in the education process. These activities generally are operated like businesses, each having financial plans and budgets reflecting revenues and expenditures. Sales and services activities generally are maintained under the same budgetary controls as academic and administrative departments, with some institutions setting aside reserves for depreciation or replacement. The governing board should be aware of the purpose and extent of the institution's sales and ser-

vices activities and be assured that the activities are necessary and beneficial to the institution's mission.

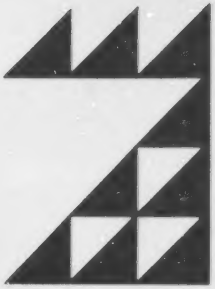
In some cases, such as residence halls, food services, and hospital services, a correlation could be sought between the cost of the service and the price charged, including depreciation and indirect costs. However, other activities might charge a price subsidized from other funds. The governing board should approve the pricing policies for these types of activities, determining to what extent any of these activities may be considered as unrelated businesses, and thus subject to reporting for federal income tax purposes.

Some services might be contracted to third parties having expertise and management skills not to be found in the institution. Whether services are managed internally or externally, the board should determine that they are being managed in an efficient manner.

Suggested Questions

1. Does the institution have policies documenting the purpose of its sales and services activities?
2. Are there policies establishing the criteria for pricing sales and services activities?
3. To what extent are the institution's unrestricted funds being used to subsidize sales and services activities? How has the subsidy changed over time?
4. Are the prices being charged competitive with those of other suppliers, if any?
5. Has the possibility of using contract services been explored?
6. Have the costs been reviewed to determine if they were fully allocated?

Chapter 3



Spending Financial Resources

The financial resources used by colleges and universities are intended to provide services to society. They are held in trust by the governing board and should be managed prudently and effectively in accordance with the institution's mission. This is a difficult responsibility because there is no single set of generally accepted guidelines for allocating these resources.

This chapter describes policies that will assist the board in overseeing the best use of the resources entrusted to it. The financial planning and budgeting processes discussed in Chapter 5 provide a systematic analysis of the institution's programs and result in resource allocation across programs and across time. The budget is not only a control document, it also gives further definition to programs.

How financial resources are spent can be examined from several perspectives. Some of the more common classifications of expenditure are:

By function	By organization	By object
Instruction	College	Personnel compensation
Research	School	Supplies and expenses
Public service	Department	Capital expenditures
Academic support	President's office	Buildings
Student services	Vice presidents' offices	Equipment
Institutional support	Etc.	Library resources
Operation and maintenance of plant		
Scholarships and fellowships		
Auxiliary enterprises		

In the planning and budgeting process (see Chapter 5), the *functional* classification of expenditures is used to identify and evaluate the institution's programs, while the *organizational* classification of expenditures is necessary for operational control and establishing budgetary authority. Classification by *object* of expenditure is useful for determining and establishing administrative policies, and is the one used in this chapter, which discusses several issues requiring policy formulation. All the issues (and many others that could be named) are related to the major objective-of-expenditure categories listed in the table above. The issues selected here are faculty and

staff, purchasing, maintaining and replacing capital assets, and energy.

Faculty and Staff

Financial policy issues concerning faculty and staff generally involve at least the following: salaries, benefits, employee relations, equal opportunity and affirmative action, faculty effort, and conflict of interest.

Salaries

Because salaries are such a large portion of the institution's operating costs, as much as 75 percent, governing boards should have an understanding of the policies used to administer those expenditures. Salary policies can be complex due to the broad range of type of employees. This diverse range includes:

Faculty
Tenured (and by rank)
Nontenured (and by rank)
Temporary or part-time adjunct
Teaching and research assistants
Staff
Salaried full-time
Hourly full-time
Student
Casual

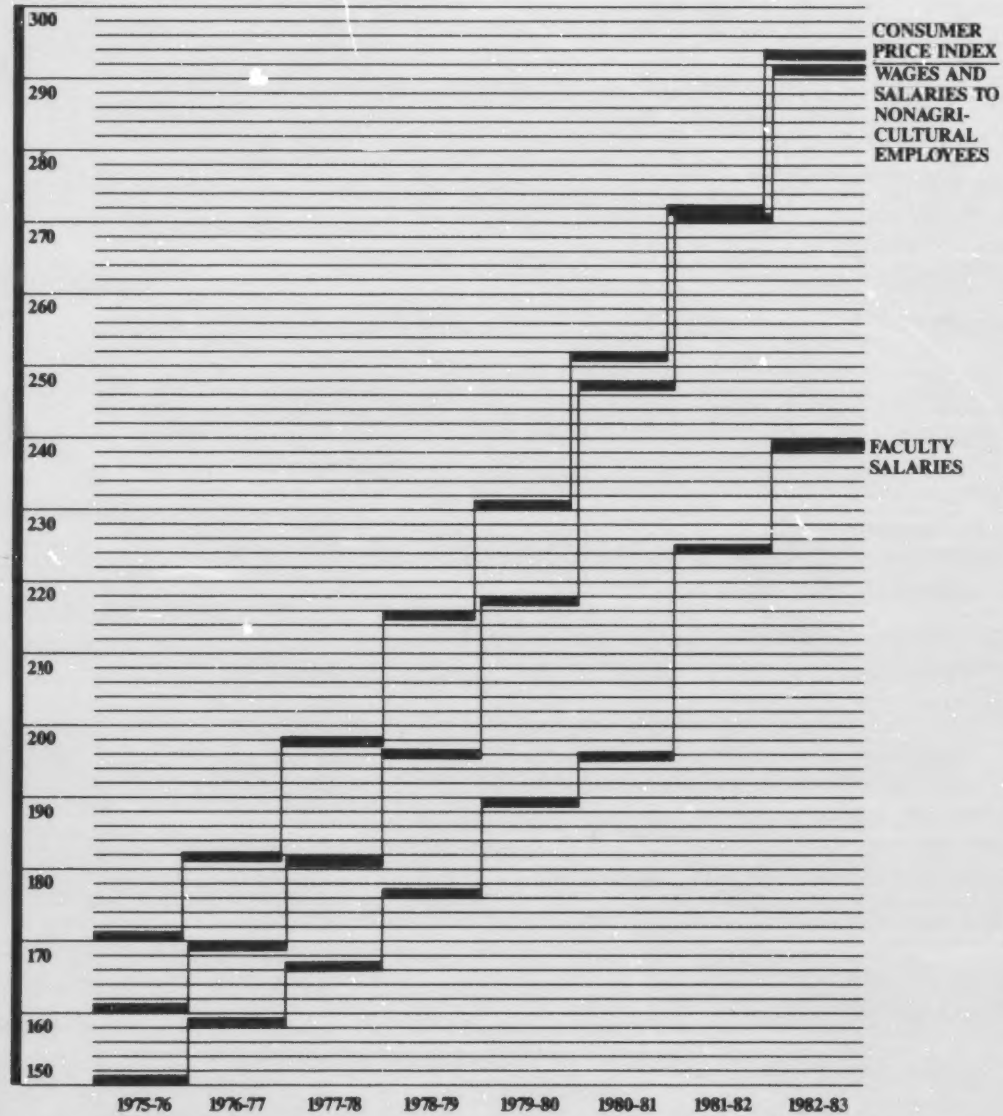
The governing board should have an understanding of the trends in faculty and staff salary levels. Two trend indicators are the change in number of students in relation to number of faculty and the change in number of administrative/support staff in relation to the number of faculty. Significant variation indicates a change in operations, of which the board should be aware. Policies relating to salaries will help ensure that salary levels are determined in a rational, well-documented manner, and in accordance with existing legislative, union, and regulatory procedures for reviewing performance and determining salary increases.

A related issue affecting the amount paid is faculty tenure. Although tenure is normally considered in terms of academic issues, it also carries significant financial implications. The governing board should be aware that as the percentage of tenured faculty increases, the institution assumes increasing long-term financial and program commitments, diminished financial and employment flexibility, and higher faculty salary levels. Thus, the board should review and approve a tenure policy, which includes:

- Terms of academic appointment

- Process of and criteria for granting tenure, if applicable
- Criteria for notice of dismissal

Faculty Pay and the Cost of Living



Source: The Chronicle of Higher Education, *June 29, 1983, Volume XXVI, Number 18. Based on Department of Labor, Department of Commerce, and American Association of University Professors data.*

Another area of concern to the governing board is competitiveness of the institution's salaries. Through the exchange of salary information with peer institutions and the use of national, state, and regional wage and salary surveys, the board should be kept informed of the institution's relative salary levels.

Suggested Questions

1. Has the governing board reviewed and approved a statement of the different types of faculty and staff categories?
2. Does the institution have a stated tenure policy? If so, how does it compare with other statements on tenure?
3. What have been average faculty and staff salary levels in recent years? How does the growth of the institution's faculty salaries compare with the growth of those in peer institutions, with the consumer price index, and relevant market salary surveys?
4. What is the history of faculty turnover?

Benefits

Faculty and staff benefits are a significant part of total compensation, and can include the following:

- Medical care
- Short and long-term disability income
- Life insurance
- Accidental death insurance
- Travel accident insurance
- Retirement and social security
- Sick time
- Vacation time
- Sabbatical and other leave
- Tuition remission

This is not an exhaustive list, and in some institutions additional benefits are offered; also, within each benefit category a variety of options is available. Benefits can be granted to employees with the full cost being absorbed by the institution, or the cost could be shared by agreement between the employee and the institution. Furthermore, certain benefits might be offered to some classes of employees and not to others.

Employee benefits might be 30 percent or more of salaries and could affect salary levels, recruiting and hiring, and union negotiations. Individual benefit options should be managed and evaluated within the context of the overall objectives of the benefits program. The policy should include evaluation of trade-offs among individual benefits and procedures for cost control over the total benefits program.

Suggested Questions

1. What is the basic objective of the benefits program? What general principle should guide how the costs are to be divided between the institution and the employee?
2. Does the policy include criteria for employee eligibility?
3. Has a procedure been established for periodic review of the cost of individual benefit programs?
4. Is there the potential of changing legislation that could affect benefit programs and their costs?
5. How do quality and cost of the benefit programs compare with those of peer institutions?

Employee Relations

The governing board should review and approve employee relations policies. The following may be included:

- Recruiting and hiring policies
- Grievance procedures
- Seniority
- Holiday, vacation, and sick leave
- Leaves of absence
- Performance reviews

Federal, state, and local laws prescribe policy in some of these areas, but stated policies are required in all of them to define the rights of the institution and those of the employee.

Another issue facing institutions and their governing boards relates to recognition of and negotiations with labor unions. The board should be aware of and should have approved the position the institution has taken with regard to unionization; unfortunately, many boards wait until bargaining units have been formed at their campuses before addressing collective bargaining issues. If the institution has an agreement with a union, the board should review strategy regarding negotiations and should be kept informed of the institution's union relations.

Suggested Questions

1. Does the institution have administrative policies for recruiting and hiring, grievance procedures, seniority, vacations and holidays, and leaves of absence?
2. What is the institution's position on unionization of its employees?
3. If there is an existing union agreement, what is the status of union relations? If not, are unions seeking to organize?
4. How effectively has the institution's administration negotiated the existing agreement(s)?
5. What has been the effect of collective bargaining on the institution's operations?
6. Is there opportunity for employee participation in planning benefit programs?

Equal Opportunity and Affirmative Action

Federal regulations and the institution's own commitment to fair practices make it imperative that programs be developed to provide equal opportunity to all persons regardless of race, color, religion, sex, age, physical or mental handicap, or national origin. The effective pursuit of equal opportunity requires not only adoption of a formal policy, but also results-oriented procedures that ensure the involvement of managers at all levels.

The policy, which should be reviewed periodically, should document the principles and organization for conducting the equal opportunity program; it should conform to all existing legislation and regulations, reflecting the spirit of equal opportunity in education and employment. A strong affirmative action program will probably result in increased costs. Additional recordkeeping, supervisory training, and administrative effort are examples of activities that contribute to increasing costs.

Faculty Effort

A recurring subject is how faculty members should spend their time. The reason this subject is never settled is that teaching, counseling students, committee work, research, and public service endeavors of the faculty are virtually impossible to quantify. However, there are several policy factors regarding faculty effort that are of concern to governing boards. A policy on faculty effort is important because of its effect on employment and retention of the faculty, the institution's finances, and quality of education.

There should be a policy that defines standard full-time teaching loads, released time available for research, guidelines for outside consulting, and the time requirements for administration, committees, counseling students, and other functions. The policy should be designed as a broad framework in which the president and academic officers have the flexibility to make faculty assignments within a wide discretionary range.

Conflict of Interest

A conflict of interest exists when a board member, officer, or other key person has an outside interest that has the *potential* of being at variance with the best interests of the institution, even though that interest might not, in fact, be financially detrimental to the institution. Examples include:

- Conflicting personal financial interests (doing business with the institution)
- Use of confidential information for personal gain
- Unauthorized disclosures of confidential information
- Gratuities

- Outside employment
- Use of the institution's time and facilities for personal purposes and other activities
- Contributions in kind

The conflict of interest policy should be designed to provide board members, officers, faculty members, and staff with guidelines that can be followed when they engage in activities that might conflict with the institution's interest. Just the appearance of conflict of interest, when in fact it might not exist, can be damaging to the institution.

Forms designed to identify conflict of interest are listed in Illustrative Exhibits. Two forms are presented there giving two possible options for the purpose of developing and maintaining adequate records. Either option can be modified or adapted, with advice of legal counsel, to institutional circumstances and board judgment. Neither form is presented as a perfect device. Boards electing to adopt a version of either form are urged to require each board member to complete and update it annually. Further, the forms should be reviewed formally on a schedule and by an official or officials determined by the board.

For a complete list of guidelines on conflict of interest, see "Guidelines for Policies Affecting Potential Conflicts of Interest" (*AGB Reports*, vol. 21, no. 1, Jan./Feb. 1979), which is available from the Association of Governing Boards. The two forms in Illustrative Exhibits are included in that publication.

Suggested Questions

1. Does the institution have a conflict of interest policy that clearly states guidelines to be followed? Does it require disclosure by board members and administrative officers of activities related to their responsibilities?
2. Has the institution experienced conflict of interest situations? If so, could they have been avoided with an effective policy?

Purchasing

An effective organization for purchasing promotes the institution's objectives by providing faculty and staff with necessary supplies, equipment, and services. Purchasing is centralized at most colleges and universities, and has as its objective to identify, select, and acquire needed materials and services as economically as possible within accepted standards of quality and service. In such a system, authorized persons within departments initiate purchase requests that are forwarded to the purchasing department, which in turn issues the purchase order.

Many independent colleges and universities have cooperative purchas-

ing arrangements resulting in lower overhead and lower prices. Purchasing procedures at public institutions usually conform to the requirements of state law. Terms of federal and state grants and contracts often stipulate the use of specific purchasing procedures and levels of documentation.

A policy statement of purchasing should include those external requirements, responsibilities of the purchasing department, and assignment of authority within the department, criteria for selecting vendors, and bidding procedures, including sole-source approval. It should also consider the special requirements for library books, periodicals, computer hardware, and scientific and medical equipment, as well as provisions for considering lease/buy decisions that arise with such items as computers, copying machines, and typewriters. Policies for evaluating contracted services of auxiliary enterprises and certain physical plant functions should also be included.

Suggested Questions

1. Does the institution have a purchasing policy that clearly defines responsibilities, organization, and criteria for purchasing?
2. Does the institution have a policy of periodically auditing the purchasing function? Have there been any significant findings requiring administrative action or review of the purchasing policy?
3. What special policies have been established for the purchase of library books, computers, and medical equipment and supplies?
4. Are there other organizations that can be joined for cost-effective joint purchasing arrangements?

Maintaining and Replacing Capital Assets

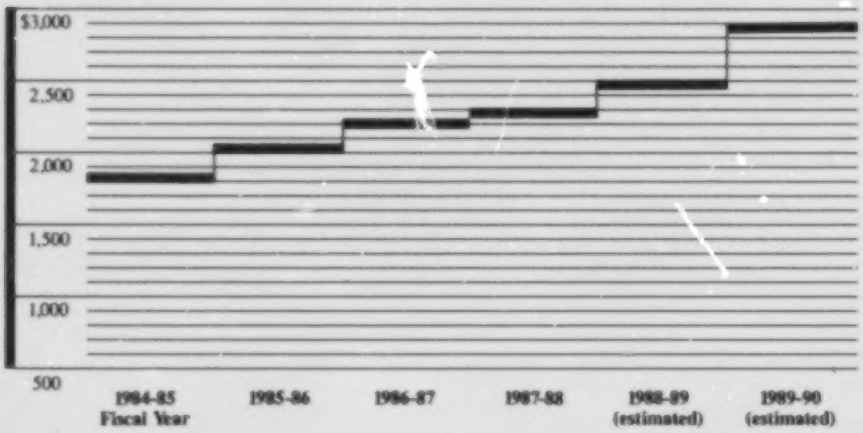
Neglecting to maintain the physical plant in order to balance budgets or to decrease deficits has led to one of the most critical situations facing higher education today. While such practice might appear unavoidable, it leads to extensive future funding requirements for such deferred maintenance, which ultimately will have to be paid for by future generations of students, taxpayers, and donors.

The governing board has the ultimate responsibility for protecting the institution's physical assets. This is a compelling, ongoing task. The members of the board should understand the process of identifying maintenance and replacement projects on a timely basis and evaluating the sequence of projects to be performed. They should know and approve the institution's preventive maintenance policies. They should know how much maintenance is being deferred and the consequences of such deferral. They should also be assured of the institution's compliance with local, state, and federal requirements regarding health and safety conditions and access for the handicapped.

Governing boards must also consider plant expansion, new construction, and replacement and major renovation of existing facilities. The rising cost of construction, coupled with the scarcity of funds, has placed many institutions in the position of not expanding. maintaining, or replacing facilities as required. Some institutions have used debt financing or unrestricted gifts for capital improvements.

This heightened awareness of deferred maintenance and the subsequent vulnerabilities and postponed financial requirements is but a part of a larger problem that has to do with the erosion of the entire financial base of many institutions — the buildings, equipment, endowment, scholarship support, working capital and all of those financial elements that bear directly upon the institution's successful future. Simply as one indicator, as the following chart illustrates, the amount of private financial support allocated to capital items over the last decade and longer has steadily declined as operating needs have pressed their case. The governing board should monitor carefully such trends, recognizing that maintaining and enhancing the capital base is central to the constructive survival of the institution in the decades ahead.

Estimate of Neglected Maintenance Cost
(Cumulative) at Hybrid University
(in thousands of dollars)



Depreciation is sometimes discussed in the erroneous context of replacing capital assets. There is a misunderstanding on the part of many who have felt that if colleges and universities had recorded an amount for depreciation in their financial records, then funds would have accumulated that would have

been available for replacement and major renovation of facilities. However, what is overlooked is that to accumulate a reserve, an institution would have had to use such means as higher tuition and unrestricted gifts otherwise available for current program needs.

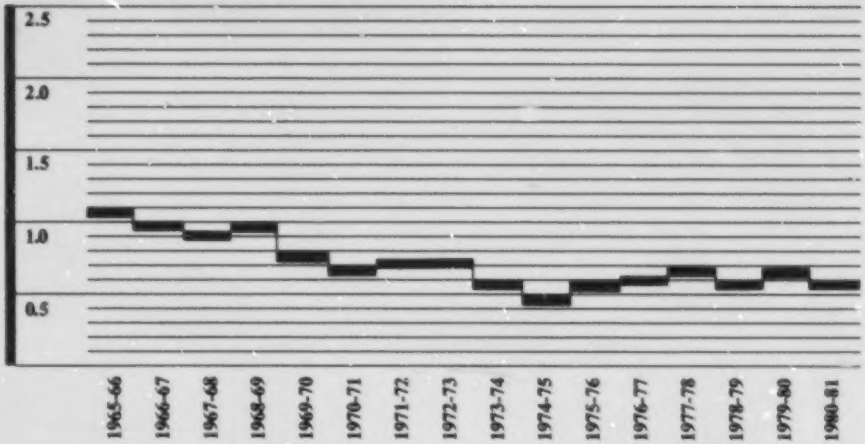
The approach for replacing capital assets is different for public and independent institutions. Most public institutions will probably continue to rely on the capital appropriation process and to justify their requests on a pay-as-you-go basis. The problem is markedly different for independent institutions: There is no readily identifiable source of funds for renewals and replacements; donors and the federal government have shown less interest in financing these kinds of projects. Some states have agencies that will obtain funds for independent institutions for constructing or renovating facilities at low rates of interest, but the annual debt service might be in excess of available funds from operations. As a result, governing boards of independent institutions might wish to consider the need for a recurring charge to be included in the operating budget that will accumulate a reserve to be used for renewals and replacements.

If an institution does not have a capital appropriation procedure with a government agency, the board should review and approve a policy defining a systematic method for financing the renewal and replacement of capital assets. As a result, governing boards of some independent institutions have adopted a policy of including a recurring charge in the annual operating budget to accumulate a reserve to be used for major maintenance, renewals, and replacements.

Suggested Questions

1. Does the institution have a systematic approach to maintaining facilities?
2. What criteria are used for budgeting maintenance expenditures?
3. To what extent, if any, has maintenance been deferred?
4. Does the institution have a plan and schedule for determining the financing of replacement and renovation of facilities?

Share of Private Voluntary Support Allocated to Current Uses vs. Capital Assets



* *Includes approximately $202 million of faculty salary endowment grants from the Ford Foundation.*

** *Includes $105 million nonrecurring transfer.*

Source: Higher Education Industry Group, Coopers & Lybrand (based on data from Council for Financial Aid to Education).

Energy

The cost of energy has risen rapidly in the recent past. While costs have stabilized somewhat, they are very high by historical standards and may yet take off to new heights. Energy is today a major expense item for most colleges and universities. The governing board should be aware of the energy issues at its institution and should see that an appropriate energy program has been developed and put into execution by the administration. The energy program can cover energy use limitations for future building construction, an energy conservation policy, and implementation programs and criteria for determining energy-saving conversion projects.

Suggested Questions

1. Does the institution have an energy management program?
2. What energy-saving measures have been taken and how cost-effective have they been?

Chapter 4

Managing and Protecting Financial Resources

Financial reports of colleges and universities present a picture in dollars of the flow of resources for a specific period and give the resulting balances available for the future. Chapter 2 discussed generating resources. Chapter 3 discussed spending resources. This chapter is concerned with the remaining balances, their purposes, and their adequacy for fulfilling the institution's mission.

Unfortunately, the reports typical of the fund accounting system, which is designed to promote proper stewardship of resources, are often confusing and unhelpful to the stewards, the members of the governing boards. Yet the board must ever be concerned with both the adequacy and the stability of the institution's capital base. To do so, members of the board should be able to read financial statements or obtain an adequate understanding from the administration or the auditors.

The principles of fund accounting are relatively simple, though some details might become complex. The fundamental theme is that supporters of the institution have varied interests among the many activities and needs of the institution and that their financial support is often designated for use solely in the area of their interest. Thus, individual funds are established as relatively free-standing financial entities, each supporting a specific area of institutional interests. As further detailed in the brief "Guide to Fund Accounting" found at the end of this chapter, the general structure of the funds usually rests on "Current," "Loan," "Endowment," and "Plant" funds.

In theory, fund accounting only requires segregating resources into the several funds as necessary to comply with the donor's or provider's specific stipulations regarding use. In practice, however, most institutions also include in the several funds resources from otherwise unrestricted funds that have been designated by the board for use for a stipulated purpose. This mixture of externally restricted funds, the use of which is fixed, and internally designated funds which can be redesignated should priorities change, requires continuing board scrutiny to appreciate not only the quantity of resources available but also their quality and the flexibility with which they can be utilized.

Working Capital

The fund entitled "Current Funds" is essentially the operating fund of the institution. Into it are received tuition and fees, receipts for services, donations for operating purposes and most otherwise unrestricted income. Expenditures are for salaries and wages, purchase of supplies, utilities, and other items that support the daily operations of the institution.

The institutional Balance Sheet, Exhibit A in the Illustrative Exhibits at the back of this book, begins with a separate balance sheet of "Current Funds." Results of operating inflows and outflows over a specific period of time leave a residual fund balance that is basically the "working capital" position of the institution. Assets and liabilities are the same as for a business if the account "Due other funds" is read as "Due other subsidiaries," and "Fund balances" are understood as the "working capital" portion of the institution's net worth.

The "restricted" current accounts differ from the unrestricted only to the extent that the use of the resources has been limited to a specific area of activity and, perhaps, over a specific period of time.

The current fund balances, both unrestricted and restricted, are key figures in the financial viability of the institution. In addition to acting as working capital, the current unrestricted fund balance represents an accumulated reserve from operations somewhat similar to retained earnings in a business. This is a most flexible reserve which provides both a cushion against future operating deficits and seed money for desirable new programs of instruction, research, and public service.

The governing board may "transfer" operating reserves, or accumulated current fund balances, to any of the long-term capital fund groups, with due consideration of any external restrictions applicable. Likewise, as needs and priorities change, the governing board may "retransfer" any funds so shifted back to current funds. The board should not only be aware of, but be required to, approve transfers of funds between major fund groups. When and to what extent current funds are invested for the future, or invested funds liquidated to support current operations, are critical decisions of governing boards.

Suggested Questions

1. Are current fund balances adequate for working capital needs? Has the institution resorted to borrowing for the current fund? From other fund groups or from external sources? Is such borrowing increasing or decreasing?
2. What are the institution's credit rating and reputation among vendors in its community?
3. Does the institution have adequate cash management? What is the short-term investment performance?
4. Are receivables and inventories under adequate review and control?
5. Are gift pledges properly recorded, collected, and accounted for?

Long-Term Capital

Long-term capital is required to finance assets that will not be recovered or converted to cash within the normal operating cycle. These assets include land, buildings and equipment, student loans, and investments to provide an independent earnings base for long-term financial support. The long-term capital funds are thus generally the "Loan Funds," "Endowment and Similar Funds," and "Plant Funds."

Resources may flow directly into these funds in the form of restricted gifts and government appropriations. Or they might first flow into the current funds and then be transferred over into any of the long-term capital funds.

The Statement of Changes in Fund Balances (Exhibit B in the Illustrative Exhibits) records these flows for each of the funds. Inflows to each fund from all sources are first presented under Revenues and Other Additions. Outflows are recorded under Expenditures and Other Deductions. Last, and of key importance to this discussion, the transfers are noted under Transfers Among Funds. The resulting totals serve to adjust the fund balances up to the reporting date, which balances are then carried on the Balance Sheet for all funds (Exhibit A in the Illustrative Exhibits). These inflows and outflows directly and indirectly into and out of the capital funds groups are most important to the administration and the governing board in formulating long-range plans and budgets for the institution. Board members have a right, indeed a duty, to require the administration to report and explain adequately past, present, and anticipated fund flows.

Loan Funds

The "Loan Funds" balance sheet (Exhibit A of Illustrative Exhibits) reports the assets, liabilities, and fund balances related principally to helping students finance their education. Until recently such capital has been increasingly provided by the federal government by various methods. With the current leveling off, even decline, of federal sponsorship other sources of such funds increasingly must be sought.

Loan funds specifically provided by interested donors are restricted to the purpose of the funds group. The gift might also require some matching funds from the institution. These matching funds then also take on the restricted provision and cannot be removed from the funds group. Furthermore, the institution might choose to transfer unrestricted resources from the current funds to the loan funds in order to increase the loan funds available to students. These unrestricted funds transfers can be reversed if the need for loan funds drops in the future.

Because loan funds are revolving and availability to future students depends on repayment by former students, and because there are never enough funds, the administration and the governing board must closely monitor the lending procedures, aging of student notes receivable, delinquency rates, collection procedures, refunds, and write-offs.

Suggested Questions

1. Have the requirements for loan funds been given adequate consideration at the time tuition and fees increases are contemplated?
2. What portion of the funds in the "Loan Funds" group is from unrestricted sources and so retains flexibility for use elsewhere?
3. What is the aging pattern of receivables? Has it shown any trends that affect availability of funds for future borrowers? How are delinquent accounts being handled?
4. Are procedures to ensure accountability of government provided funds adequate?

Endowment and Similar Funds

The separate balance sheet and report of changes in fund balances for "Endowment and Similar Funds" are found next in Exhibits A and B in the Illustrative Exhibits. Endowment assets generally are comprised of two classes of resources joined together in common use toward a common objective. Thus endowment has been limited by the donors at the time of the gift to providing a capital base for the institution. Quasi-endowment (or board-designated endowment, or funds functioning as endowment — all titles are used) are those funds which have been accumulated from previous years' operations and designated by the governing board to function as a part of the endowment capital base. These funds, being normally unrestricted, are eligible for redesignation for other purposes should needs and priorities change.

Nowhere else is the governing board's constant dilemma of choice between obligations to the present versus future constituencies brought more sharply into focus than in its management of endowment and other long-term invested funds. Most independent colleges and universities would not exist were it not for the thrift and foresight of earlier administrations and governing boards. Endowment fosters independence. Endowment enables an institution to offer new programs and services. Endowment can mean the difference between survival and bankruptcy when financial viability is threatened. It is often a major portion of the net worth of an institution.

Yet current operating needs also are pressing. The opportunity to maximize current contributions of endowment investment to the current operations at the expense of longer-term capital needs is attractive today in the face of troublesome financial conditions in colleges and universities. Yet the future, too, has its needs. The manner in which governing boards deal with this eternal

quandary will have a major impact on the current and future health of their institutions.

Managing the endowment funds should be a matter of central concern to the governing board. Policies and guidelines for investment should be clearly established and regularly reviewed. Responsibility for management of endowment funds under the established policies and guidelines should be clearly understood, whether it be by the board itself, by a committee of the board or, as seems to be standard practice, by professional managers. And investment management must constantly be monitored and evaluated.

Annuity and life income funds, which are trust funds, are a special group of funds temporarily committed to the support of the donor (or a designated beneficiary) for lifetime or for some other stipulated period after which the remaining funds come to the institution. Such agreements, together with investment management and reporting obligations to donors and beneficiaries, involve substantial legal, accounting, and tax considerations. The governing board should be sure adequate professional expertise has been made available and followed in soliciting, accepting, and managing these funds. In the case of these funds, the governing board is responsible to more parties than just the institution.

Suggested Questions

1. How much in current funds has been transferred to quasi-endowment and how has this changed through the years?
2. Has the growth of endowment capital kept pace with inflation and so retained its purchasing power? If not, how can this be improved in the future?
3. Has the income provided by endowment maintained its proportional contribution to current operating budgets?
4. Are adequate policies and procedures for managing endowment investment in place and subject to regular review?
5. Is a regular evaluation of investment performance undertaken? What is the relative performance matched with other institutions? How might it be improved?
6. Are adequate procedures in place and followed for managing life income and annuity funds held in trust for the donor and beneficiaries as well as for the institution?

Plant Funds

Plant Funds, for which the balance sheet and changes in fund balances are found in Exhibits A and B in the Illustrative Exhibits, often comprise the largest single portion of the institution's net worth. This can be misleading because most of the resources are tied up in bricks and mortar and thus effectively frozen from the more flexible assets. Land, buildings, and major equipment are entered on the books at acquisition cost and remain that way until sale or demolition.

The more flexible categories of plant funds, such as those for renewals and replacements and for retiring indebtedness, require the continuing attention of the governing board. While some resources might flow into these categories from outside donors and agencies, most will have come from current funds through board-approved transfer. Indeed, the adequacy and stability of this flow of unrestricted funds coming from current operations are often the key factors in protecting and maintaining the value of the physical plant through well-planned programs for renewal and replacement.

While the concept of depreciation is generally absent from an institution's accounting procedures, some planned accumulation of expendable funds for renewal and replacement should be considered by the governing board. Wear and tear on the physical plant is a very real cost of ongoing operations, even though corrective expenditures might not come on an annual basis. Some institutions now put in the operating budget a regularized capital charge, which is transferred to a reserve in the plant funds group to finance such renewal and replacement as the need arises. Without such a procedure or its equivalent, over time the institution is vulnerable to a gradual deterioration of plant and equipment. Such deterioration is not recognized in either operating statements or balance sheet valuations. This is clearly a matter of central importance to governing boards.

Suggested Questions

1. Have the administration and the board provided an adequate flow of funds to preserve the value of the physical plant? How does this amount compare with provisions for depreciation of plant and equipment as is the practice in business?
2. Is there a program in place for renewing and replacing physical facilities? How are the priorities established?
3. What is the justification process for investing in new facilities or disposing of old facilities?
4. What has been the trend of expenditures for maintaining, replacing, and renewing the plant in the past? What are the anticipations for the future?

Total Capital

Some appreciation of the adequacy of an institution's financial resources might be revealed in trends of the fund balances, the institution's capital or net worth, in mix and in toto, over the years (see Report No. 18 in Chapter 6). More "prior year figures" could be added to those extracted from Exhibit A, "Balance Sheet," as follows:

	Current year	Prior year
Current fund balances—unrestricted	$ 643,000	$ 455,000
Current fund balances—restricted	446,000	421,000
Total "working capital"	1,089,000	876,000
Loan fund balances	683,000	502,000
Endowment and similar fund balances	14,000,000	11,901,000
Annuity and life income balances	3,220,000	2,505,000
Plant fund balances:		
Excluding net investment in plant	1,760,000	2,793,000
Net investment in plant	38,210,000	36,540,000
Total capital, equity, or "net worth"	$58,962,000	$55,117,000

As in profit-oriented businesses, "working capital" can be compared with operating budgets, currently and over the years. The endowment and similar funds balance can be compared with numbers of students, tenured faculty, indebtedness, and other kinds of long-term obligations. It might be discounted for losses in purchasing power of the dollar. It should be measured for its relative contribution to current operating budgets over the years. Uncommitted plant funds can be compared with net investment in the plant and with debt service requirements to estimate adequacy in covering anticipated capital outflows for plant replacements and debt retirement.

Again, as in any business, debt amounts and trends can be measured for reasonableness against the assets financed by debt. Debt service costs can be measured against additional revenues or net cash flows anticipated from the assets financed. Debt can also be compared with totals of unrestricted and restricted funds that could be made available for repayment. It should be noted that although there might be unrestricted fund balances in the various fund groups, such amounts might not be in cash or be readily convertible into cash for other purposes. As in any business, the assets of a college or university have varying degrees of liquidity with quite different "book," "going concern," and "liquidation" values.

Long-Term Debt

Incurring indebtedness might be a cost-effective solution to obtaining necessary facilities expansion or replacement. However, assuming and paying principal and interest require careful consideration of need, sources of funds, and possible limitations of funding agencies. The governing board and administration should agree on policies and procedures for incurring debt. Any collateral offered must be reviewed for third-party restrictions. Limitations on types or levels of debt should be established by the board. Operating

and maintenance costs of the additional or replacement facilities must be considered as well as the debt service requirements.

Suggested Questions

1. Are the amounts and allocation of capital in line with the needs of the current institutional profile? Is the loan capital adequate in view of current student population and current tuition and fees? Is working capital adequate to support the size and quality of the current educational operations? Is quasi-endowment adequate as a reserve for use if major financial crises strike?

2. Does the board approve all borrowing? Is debt increasing or decreasing as a percentage of investment in the plant? Is debt service increasing or decreasing as a percentage of the current operating budget?

3. What have been the trends in working capital and long-term capital over the years? What do these trends say about the degree of financial viability of the institution?

Protecting Resources

Protecting the institution's resources and avoiding potential liabilities is an important responsibility of the governing board. The administration recommends internal control policies and practices for financial, administrative, and operational activities, and the board is responsible for approving them. There are many policies to consider, but the only ones discussed in this section relate to audits, risk management and insurance, patents and copyrights, and legal counsel.

Audits

The governing board should be assured that the institution's activities are subject to audit. Audits may be performed in separate but coordinated efforts by internal and external auditors (the latter includes public accounting firms and state and federal auditors).

Audits performed by both internal and external auditors are designed to ascertain that the overall system of internal control is adequate and effective, and functioning to safeguard the institution's resources. They should also determine that financial transactions are properly approved, recorded, summarized in the records, and properly classified in reports. The auditors should see that financial transactions are in accordance with the policies of the board and that they comply with applicable laws, regulations, and donor restrictions.

Internal and external auditors are not in competition with each other; rather, the internal audit team complements the external auditors. While a close relationship should exist, there are distinct differences because their work varies in scope and final objectives: Internal auditors perform detailed reviews of the institution's activities to apprise management of the adequacy of controls, policy compliance, procedures for safeguarding assets from fraud, and

sometimes performance of employees in carrying out assigned responsibilities. Independent external auditors attest that the financial statements of the institution are prepared in accordance with generally accepted accounting principles applied on a consistent basis.

The external audit should include tests and evaluations of internal controls and of compliance with financial policies; such an audit should also include a management letter. Most of the tests are similar to but less extensive than those performed by the internal audit group. Work of federal and state auditors, which is also identified as external, typically concerns specific activities, and thus more clearly relates in objective and scope to that of internal auditors.

The governing board, by establishing an audit committee of other means, should stress the importance of the audit function and should meet with the internal and external auditors to discuss material findings and recommendations. This committee should fully understand the audit procedures required to render an opinion. Discussions are encouraged both before the audit begins and after it is completed to provide the necessary level of assurances desired by the committee. The committee should meet with management to determine the actions taken on comments included in the management letter of the external auditors.

The audit committee recommends and the governing board should appoint the external audit firm. The firm should be chosen based on the quality of its staff, its audit program, and on economic considerations. The board or audit committee should review the scope of both internal and external audit plans before they are implemented and should request any special audits to be taken.

Persons performing the internal audit may report to either the chief business officer or the president of the institution, depending on the supervisory capacity of the manager of internal audit or the president's interest in overseeing the internal audit function. In either case, the governing board should require that the internal audit function have formal access directly to the audit committee and to the president.

The governing board might find that supplementary schedules would be helpful for relating audited reports to the budget. If so, such schedules should be requested of the auditors or the chief business officer.

Risk Management and Insurance

The governing board should be apprised of the risks and potential losses the institution could encounter. Generally these risks are not predictable and include (1) claims that charge mismanagement, malpractice, discrimination,

or copyright infringement, (2) uninsured losses against theft or catastrophe, and (3) deductibles on insurance claims. Risk management includes a systematic and continuous identification of potential risks and adoption of the following:

- Financial, administrative, and academic policies
- Good security
- Personnel policies
- Safety program
- Inspection program
- Adequate insurance coverage

Some risks having minimal loss potential or predictable costs can be absorbed through the operating budget. Other risks, which are too infrequent to be predictable and too large to be financed internally, require funding by self-insurance reserves or by obtaining insurance coverage.

The board should be aware, through periodic reports of the various levels and kinds of risks, of management's plans for handling the risks and of how the plans are to be financed. The effect of inflation on the value of property and the size of potential claims should be monitored closely.

Patents and Copyrights

The governing board should be assured that all inventions and copyrightable material of value belonging to the institution have been protected through patents and copyrights. This requires adopting policies and practices for identifying material subject to patents and copyrights. It also requires professional expertise to process applications adequately and to manage any patent or copyright material.

Patent and copyright policies should establish and define the rights and obligations of sponsors, the institution, and its employees. Such policies should expressly state ownership rights, distribution of royalties, and any obligation to market original work.

Legal Counsel

More than ever before, colleges and universities are involved in legal matters. This is due to many factors, among them an increasingly litigious society and more federal and state laws affecting higher education, especially with respect to personnel and students. In protecting the institution's resources, the governing board has an obligation to ensure that all legal matters are reviewed by counsel. Contracts entered into by the board are an example; these may commit the board for many years.

Every institution should have a lawyer. Staff counsel, external counsel, or both might be used, the choice depending largely on the size of the institution and on the specialties required. State attorneys general sometimes act as counsel for public institutions, and in some independent institutions legal services are provided by one or more members of the board. Whether counsel is internal or external, one person in the administration should be the coordinator of all legal concerns, acting as liaison to the legal advisor.

Suggested Questions

1. Does the audit committee annually review the scope of the external and internal audit programs?
2. Does the audit committee review management's responses to the written comments of the internal and external auditors with respect to internal control weaknesses, operating efficiencies, and the condition of the institution's resources?
3. What risks are self-insured by the institution? Are adequate reserves maintained?
4. What are the results of reviews undertaken to determine potential risks such as malpractice, discrimination, fire, and theft? What actions have been taken to reduce exposures?
5. What is the institution's policy for identifying and owning patentable inventions?
6. Does the institution conduct audits of patent licenses in accordance with its rights included in the license agreements?
7. Has the institution's legal counsel reported to the board on the status of pending legal matters?

Guide to Fund Accounting

The principles of fund accounting for colleges and universities are contained in NACUBO's *College & University Business Administration* (1982) and in several other authoritative references. The following explanation of fund accounting emphasizes how to read financial statements presented in a fund accounting format.

Classification by Restriction

The principles of fund accounting evolved from fiduciary responsibility; their purpose is to ensure that financial resources are managed in fulfillment of the obligations attached to them. Fund accounting allows for the orderly separation of resources whose uses are externally restricted from resources that have no restrictions on use. Since funds entrusted to a governing board are often for a specific purpose, such as student financial aid, a new building, or a specific research project, the board and administration require a method to systematically account for funds having such restrictions.

Classification by Fund Group

In addition to being restricted and unrestricted, funds are also classified

into *fund groups* that reflect the purposes of the resources. For example, all resources to be spent for construction of buildings are shown in a "Plant Funds" group. These separate fund groups can be displayed in columns having the following labels, although additional columns might be appropriate, depending on the institution:

- Current Funds
- Student Loan Funds
- Endowment and Similar Funds
- Plant Funds

Current Funds. These funds have been given or paid to the institution in support of its current operations. They can be used for such purposes as paying salaries, buying equipment, and providing scholarships and fellowships. It is this column that is managed through the operating budget process; it also contains some of the savings the institution has accumulated that may be used to support future operations.

The "Current Funds" column is divided to recognize restrictions and other limitations donors, payers, or trustees have attached to the funds. This classification can be displayed as follows:

Current Funds	
Unrestricted	Restricted
Not Designated	Designated

Unrestricted funds can be classified into those that are *designated* and those that are *not designated*. The "Designated" column is for funds the institution, rather than an external source, has specified are to be used or saved for a particular purpose. The financial activities of self-supporting activities such as hospitals, residence halls, and bookstores could be shown in this column. Also, if a department or other entity has been allowed to accumulate savings from unrestricted sources to use for its own purposes, that amount could be shown here. The "Not Designated" column is for funds that can be used for any institutional purpose; typical sources of such funds are tuition, appropriations, and unrestricted gifts from donors. Report Nos. 15-18 in Chapter 6 illustrate the various classifications discussed above.

Student Loan Funds. The funds in this column cannot be spent for operations, but are loaned to students to assist them with their costs of education. These funds come from such sources as private donors and the federal government; another source is the institution itself, where funds may have been

designated by the governing board for this purpose. As these loans are repaid, the principal and interest are loaned to other students.

Endowment and Similar Funds. Endowment funds are received from donors on the condition that the gift be maintained in perpetuity (true endowment) or for a specified period of time (term endowment). Also in this column, but separately identified in Report Nos. 15, 16, and 18 in Chapter 6, are quasi-endowment funds, which the governing board has decided to treat as though they were endowment, and funds that have annuities or life income trusts attached to them. (If they are material in amount, annuity and life income funds could be a separate fund group, as shown in Exhibits A and B earlier in this chapter.) Endowment income that can be used for current purposes (either restricted or unrestricted) is recorded in the appropriate current funds column.

Plant Funds. The plant funds are divided between unexpended funds and those previously invested in equipment, buildings, and grounds, as follows:

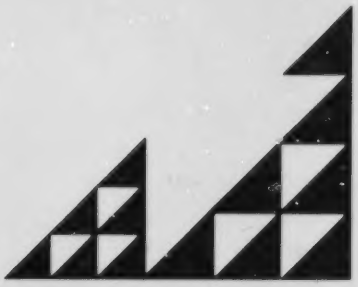
Plant Funds	
Unexpended	Investment in Plant

Unexpended plant funds are those that have been received for buildings or other facilities, along with funds the governing board has designated to be used for improving the facilities or for repaying debts. When these funds have been used for construction or debt repayment, the value of the new or paid-for facility is added to the "Investment in Plant" column at its new or paid-for cost. (The authoritative references have separate fund subgroups for renewals and replacements and for retirement of indebtedness, as can be seen in Exhibits A and B; for purposes of this discussion, however, they are merged with the unexpended plant funds.)

Note: The section "Results of Operations" on pages 84–91 continues the explanation of how each of the funds mentioned above can be reported to the governing board.

Chapter 5

Planning and Budgeting



The previous chapters have discussed some of the management issues affecting the revenues, expenditures, and financial resources of the institution. These issues should be systematically addressed through establishing policies and implementing a sound planning and budgeting process. An active and committed governing board, interested in understanding the issues facing the institution, is a valuable asset to the planning and budgeting process.

The governing board has several responsibilities to fulfill in assuring itself that the long-range plans and budgets have been effectively developed. These include:

- Organizing itself to address effectively the planning and budgeting activities. For most boards this would involve establishing a committee that would be responsible for detailed briefings to the full board. For many boards it would involve coordinating the committees having responsibility for various aspects of the plans and budgets, such as the academic program committee, finance committee, and buildings committee.
- Developing, with the administration, a planning and budgeting calendar of when decisions on such items as tuition rate, endowment payout, salary increases, and proposed new programs must be brought to the board for consideration. The calendar will vary among institutions because the sequence of events is affected by such factors as the government legislative process, academic calendar, and number of board meetings per year.

The value of planning and budgeting is that it provides the focus for directing the accumulation and use of resources in a way intended to be most beneficial to the institution's mission. When the board can assure itself that planning and budgeting are major undertakings of the administration and that they actually serve as the context for future decisions, then there is good reason to believe the institution has the structure for good management.

In addition to seeing that the institution and the board have been organized to emphasize planning and budgeting, the board has other opportunities for contributing to the planning and budgeting process. One of these is to examine the context in which the plans and budgets are being developed. Two natural

issues to examine, as mentioned in Chapter 1, are the institution's mission and its environmental conditions.

Reviewing the institution's mission. At the beginning of each planning cycle, the board should be asked to review and assess the institution's mission (see the first part of Report No. 2, Statement of Mission, in Chapter 6). The purpose of this review is to reconfirm that the institution's mission continues to be based on a societal need and that the need will continue. The board should verify that the institution's activities have been consonant with its mission and that there are no major weaknesses. (Much of the material contained in Chapter 1 and in Report No. 1, State-of-the-Institution Report, in Chapter 6, is useful for this appraisal.) The board, as overseer, assumes the ultimate responsibility for either keeping the institution moving in the direction of its mission or going through the complex process of reappraising the adequacy of the mission as it currently exists.

Evaluating the impact of environmental conditions. The environmental factors outlined in Chapter 1 and illustrated in Report Nos. 3 and 4, Environmental Assumptions, in Chapter 6 are of critical importance to the board; they provide a background for creating the plans and budgets. During the early stages of each planning cycle the board, with the administration, should have the opportunity to decide how such factors as national enrollment trends, inflation, energy, and federal government priorities are expected to affect the institution. Especially for public institutions, the actions (and anticipated actions) of state and local governing authorities need to be well understood and their effect measured. If the board understands these influences, it can knowledgeably examine and ultimately approve the plans and budgets. In many respects, these resulting documents will be reactions to the anticipated effects of the external conditions.

Up to this point in the process the board has been shown to have a useful role in providing leadership for planning and budgeting based on an understanding of the context in which plans and budgets are created. In the next stage of the process the board has the opportunity to influence directly the course of the institution. This substantive role involves at least three issues:

1. Evaluating competing program goals. Governing boards should anticipate that there will always exist a healthy competition among program priorities. The planning process provides the occasion to evaluate existing programs — academic as well as support — to determine their effectiveness and whether they should be continued. Programs should be periodically examined in detail, possibly through establishing self-study groups involving faculty, students, administrators, and trustees. The self-study analysis would evaluate

the academic strength, content, and resources used for the program and compare it with similar programs in other institutions. The board should actively encourage a systematic analysis of existing programs.

2. Reviewing proposals for new programs. During the planning and budgeting process the governing board has the responsibility to review proposals for new programs. These proposals could include new departments, research centers, and degree programs that will commit the institution to expending substantial resources. The board should evaluate the merit of such proposals in relation to the institution's mission. It should also critically examine the long-term financial obligations inherent in these proposals, which may include additional facilities, tenured faculty, and administrative and support costs. The board should examine the feasibility of any proposed increase in tuition, activity fees, appropriations, and sponsored project revenues designated to pay for the cost of the new programs.

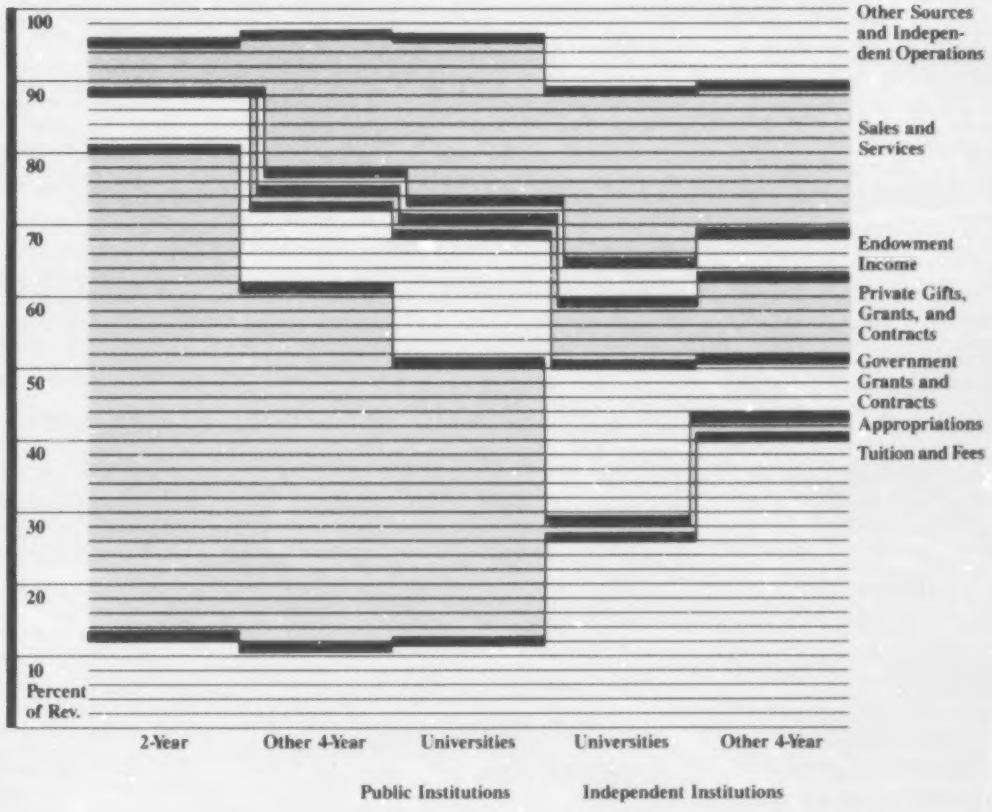
3. Balancing the future against the present. The governing board assumes the difficult task of balancing current and future needs. Such decisions as (1) spending accumulated reserves to balance the budget, (2) increasing tuition, (3) implementing major renovation programs, and (4) determining the amount of unrestricted gifts to save involve judging whether resources should be spent now or protected for future student generations. The decisions made in these areas will depend greatly on the environmental factors described in Chapter 1 and illustrated in Report Nos. 3 and 4 in Chapter 6. Related to this issue is the subject of financial viability; the planning process should be the occasion for evaluating the adequacy of such items as size of the endowment, condition of physical plant, and amount of working capital.

The board's program review, evaluation, and decisions depend on developing effective and well-documented "decision packages" prepared by the administration. The introduction to this monograph described several principles and techniques for improving presentations at this important and difficult stage of the planning and budgeting process.

At the time the governing board is examining the program aspects of the institution's plans and budgets it also needs to understand the financing strategy. The financing strategy can be defined as the plan that identifies the revenue sources available and describes how they are combined to finance the programs.

The accompanying figure shows the diverse (but not unexpected) funding patterns for five different types of postsecondary institutions. Even within these types there are major differences in funding patterns. The patterns and resulting funding strategies are due to a combination of differences in institu-

Comparative Sources of Revenue for Colleges and Universities
by Type of Institution



Source: National Center for Education Statistics, Financial Statistics of Institutions of Higher Education, Fiscal Year 1976.

tional mission and form of governance.

The financial management issues addressed by governing boards vary, depending on the funding strategy employed for the type of institution. The various revenue sources are affected differently by such factors as enrollment patterns, political climate, economic conditions, and government priorities. For example, a public, two-year institution depends heavily on the changing political, social, and economic factors of the local community. A private university is concerned with a different set of factors such as general economic conditions, tuition, donor relations, financial aid requirements, federal educa-

tion and research priorities, and its continuing ability to recruit a desired student body.

Since environmental factors affect the revenue process differently, it is possible that one type of institution, because of its funding sources, can be in relatively stable financial condition while another will be adversely affected.

There are other factors governing boards should be aware of when discussing the funding strategy of their institutions. These factors affect the flexibility, stability, and control of revenues and include:

"Hard" and "soft" money. A distinction should be made between revenues that are recurring ("hard") such as tuition and appropriations and those that are nonrecurring ("soft") such as those received from grants and contracts. If an institution relies heavily on soft money to fund its long-term commitments such as tenured faculty, it has a relatively risky funding strategy. Board members should understand how stable the institution's funding is.

The interrelationships of revenues and expenditures. Relationships often exist among revenues, which make the amount of one source of revenue dependent on others. For example, gifts to endowment ultimately affect endowment income, and tuition levels often depend on the amount of public funds appropriated. A second relationship is the change in expenditures because of a change in revenues, such as when an increase in tuition causes an increase in the need for financial aid. A third relationship is the change in revenues because of a change in expenditures; this may be illustrated by the cost of housing and food services, which determines the price and ultimately the revenues that are received. On the expenditure side, the governing board should differentiate between one-time expenditures and continuing expenditures, such as buying a computer or constructing a building on the one hand and paying salaries of tenured faculty or maintaining a building on the other. The one-time expenditures, however, should be an integral part of the operating budget, where they are subject to frequent control and evaluation.

Given the numerous and complex responsibilities the governing board has in planning and budgeting, a natural concern is how to develop systematically a method by which the board can carry its weight in the process. As emphasized throughout this monograph, the board depends on the quality of the information the administration supplies to it. A board will be better prepared and better able to respond effectively if the planning and budgeting process is developed, reviewed, and approved over several meetings.

Generalizations concerning board involvement are perhaps inappropriate because of the variety of board committees, form of governance, and frequency

of meetings; however, the following case might help to illustrate effective board involvement in planning and budgeting. It illustrates the role of the board in the process and the presentation of materials to the board.

Assume a public institution with a board of eight members, which meets four times a year; there are no committees of the board.

September Meeting:

Objectives:

(a) Examine the environmental factors currently affecting the institution and how they are expected to change over the next year.

(b) Review the past financial performance of the institution by examining the annual operating reports and the external audit reports.

(c) Review the current budget and any recommended changes.

December Meeting:

Objectives:

(a) Establish the assumptions to be used for creating the financial plans and budgets. These could include inflation assumptions, estimated salary increase requirements, tuition increase, and endowment payout rate.

(b) Review the current budget and any recommended changes.

March Meeting:

Objectives:

(a) Examine the proposed plans and budgets, specifically approving (if appropriate) any new programs.

(b) Review the current budget and any recommended changes.

June Meeting:

Objectives:

(a) Approve plans and budgets based on the actions of government authority. Approval should include authorization for the following year's budget, salary increases, and new program offerings.

(b) Review and assess current year's financial activity.

Though the case is oversimplified, it illustrates the systematic presentation of materials to the board. The various presentations build on information previously provided to the board which, in a natural process, leads the board to the ultimate decision of approving the institution's plans and budgets. Boards meeting more frequently and having several committees have the opportunity for greater participation in the planning and budgeting process.

The next chapter more clearly describes the interrelationship of the plan, budget, and operating statements. Also, the reports in that chapter illustrate

in greater detail the kinds of information and the formats that will assist governing boards in their deliberations on plans and budgets.

Suggested Questions

1. Has the governing board examined the institution's mission in comparison to its actual program activities?

2. To what extent have the institution's environmental conditions affected the long-range planning?

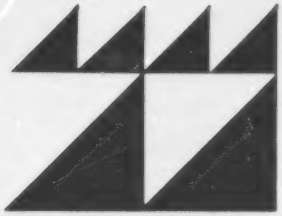
3. Does the board critically examine the sources of funding for new programs?

4. Has the board established a policy of having existing programs critically examined for purpose and substance?

5. To what extent has the institution's financing strategy been articulated and justified by the administration? Has the board established a policy of having existing programs critically examined for purpose and substance?

5. To what extent has the institution's financing strategy been articulated and justified by the administration?

Chapter 6



Implementation

The preceding chapters have identified financial policy areas of concern to governing boards and have suggested ways for the administration to transmit financial data to the board. This chapter presents an approach for bringing the preceding chapters together and integrating their suggestions into a system of reporting that will enable the board to carry out its responsibilities. The basic system is described here, with illustrative formats for reports that could be provided to the board. There are also several subsets of reports, which can be used as the board's interests expand into specific areas, or as time permits, or as priorities of issues require that more detailed information be available. The basic reporting system, which should exist in every institution, is composed of the following:

1. **State of the institution** (see Report No. 1)
2. **Long-range plan and budgets** (see Report Nos. 2-11)
3. **Operating reports** (see Report Nos. 12-14)
4. **Results of operations** (see Report Nos. 15-18)
5. **External auditor's report** (see Illustrative Exhibits)

The reports presented in this chapter for Hybrid University are based on data contained in the "Illustrative Exhibits," which follow this chapter. It is important to note that these reports only *illustrate* the principles contained in this monograph. There is no intention to imply that the formats presented are prescriptive or are preferred over other alternatives; neither are they comprehensive. Each institution's governing board and administration should determine collectively what kinds of information and what formats are appropriate for their requirements. The information should then be tested to determine if it is, in fact, useful.

All the reports in this chapter have a specific reference point. The assumption is made that the institution is operating in the fiscal year 1984-85, and is reviewing all these reports in January. This consequently assumes that the proposed budget is for fiscal year 1985-86, that the prior year's report is for fiscal year 1983-84, and that the four years included in the long-range plan begin in 1986-87.

State of the Institution

Report No. 1. The purpose of the annual state-of-the-institution report is to provide the governing board with an overview, described in Chapter 1, that will allow it to examine change in such areas as drawing power, institutional environment, and financial health. To do so, the report must show trends; this will require at least three successive years of information. The report below, for Hybrid University, illustrates parts of one of the subjects mentioned above, namely, drawing power. Other reports should be designed to present information on additional areas.

Report No. 1
State-of-the-Institution Report
Issue: Drawing Power
Hybrid University

First Concern: What is the institution's present drawing power, and what is the trend?

	Fall Term		
	1984	**1983**	**1982**
A. Types of students applying for admission.			
Average SAT scores (if applicable)	945	952	958
Percentage requesting financial aid	77%	82%	79%
Percentage minority applications	18%	16%	15%
Percentage applicants less than 20 years old	96%	97%	97%
Full-time/part-time students	17:1	15:1	14:1
B. Selectivity ratios.			
No. applicants admitted/No. applicants	87%	82%	64%
No. enrolled/No. admitted	54%	55%	59%
C. Retention ratio.			
No. seniors/No. students in original freshman class	38%	37%	37%

Other concerns on the issue of drawing power could relate to state and national trends. For example, the following questions could be asked:

1. *What changes at the state and national levels are affecting drawing power?*
   a. *Kinds of students seeking admission within the state and at the national level.*
   b. *Kinds of state and federal legislation that may affect financial aid.*
2. *What are the numbers of potential students within the state and at the national level?*
   a. *Numbers of 18-year-olds at the state and national levels.*
   b. *Numbers of 18-year-olds at the state and national levels attending college.*

Long-Range Plan and Budgets

Report No. 2. As the administrators and governing board deliberate on the future of the institution, they should annually review and reaffirm its mission and goals. The statements of mission and goals need not necessarily be changed unless there has been recognition of a need for change. Reviewing the statements will help to ensure that the plan and budgets are consistent with them.

The mission statement should be brief and should state in general terms the overall purpose of the institution. The statement of Hybrid University's academic goals below contains only those goals related to students and faculty, but additional statements should be prepared for such areas as individual academic programs, undergraduate and graduate education, research, public service, and student access.

Report No. 2
Statement of Mission and Goals
Hybrid University

Statement of Mission

Hybrid University is a small university dedicated to providing excellent educational opportunities in liberal arts, engineering, and business administration. Special emphasis is devoted to providing continuing education opportunities to residents of the nearby urban community.

Statement of Academic Goals

Students. Hybrid University strives to achieve a balanced student body with strong representation of minority and women students. It is expected that regular students be full-time and that only a small fraction take less than a full load. Only students in the continuing education program are encouraged to be part-time.

Faculty. Hybrid University seeks to have an excellent teaching and research faculty and has a policy that at least 80% have a doctoral degree. The ratio of tenured faculty is closely monitored and is maintained at less than 65%. The university is also committed to seeking a balanced faculty, with special attention being given to women and minorities.

Other statements would describe individual academic programs, undergraduate and graduate education, research, public service, and student access.

Report No. 3
Environmental Assumptions
Hybrid University

External

Economic situation. The national growth rate may be lower, perhaps negative, and inflation will remain steady, at least 5%. Secular unemployment may persist. Per capita income will grow more slowly. The growth rate of the local community should continue to increase due to the shift in population to this state and to the effective utilization of its natural resources, primarily coal and water.

Construction price index. Current trends indicate an increase ranging from 3% to 5% over the present. Capital budgets have been adjusted to reflect the estimated increase in the construction index.

Alternative educational patterns, continuing education. The most pervasive influence is the decrease in traditional college-age students, the increase in older adults seeking education, and the continuing increase in the number of part-time students. The university is responding to these changing conditions with the new External Degree Program and offerings in the Division of Continuing Education, in particular the "Weekend College."

National attitude toward higher education. People are concerned about the high cost of college and by the perceived inability of collegiate training to prepare people adequately for jobs. Higher education will probably decrease in importance for funding among other social priorities such as health care and full employment.

State attitudes toward higher education. This state's residents will continue to support colleges and universities with enthusiasm. They will continue to demand more services and opportunities, and their confidence will be retained at its present high level.

State aid to independent colleges. The state's residents generally oppose use of public monies in support of independent higher education. However, state appropriations are presently being made to several independent colleges, which may gain even more support from the legislature.

Other issues to include may be local and regional labor market trends; governmental regulations; labor union activity; national trends in tuition; and national faculty salary trends.

Internal

Students and Faculty. The tuition rate for 1984-85 is $2,100, with the expectation that it will rise to $2,600 for the academic year 1989-90—a compound annual growth rate of 5%. For this same period, FTE enrollment is expected to remain steady at 1,725.

Size of the faculty is also expected to decline during this period, from 122 to 92, with most of the decrease due to retirements and turnover.

The need for financial aid continues. At the federal level, it is anticipated that student aid may remain steady or may even decrease slightly. However, current and proposed federally sponsored aid programs should cover much of the increased costs. Currently, institutionally based aid is $271,000, which is allocated among 865 students. It is estimated that by 1989-90 the aid requirement will increase to $346,000 for the same number of students.

Faculty compensation will continue to increase regularly in order for the institution to maintain a competitive position with the compensation of peer institutions. Increases in insurance premiums and social security taxes are raising the cost of benefits at a rate greater than that of general inflation. Special attention should be given to the salaries of junior faculty, which have fallen behind the national average for this type of institution. Compensation to the faculty is currently $4.075 million. In anticipation of a decrease in the number of faculty (from 122 to fewer than 100), total faculty compensation is expected to decrease slightly to $3.919 million in 1989-90. Stated another way, average faculty compensation will grow from $31,800 to $42,600 by 1989-90, a compound annual increase of 5%.

With regard to unionization, unless enabling legislation is passed by the state legislature, it is unlikely that union influence will increase. On the other hand, if new laws are enacted, it is possible that union activity will increase.

Additional material would be appropriate for:

- *Description of, justification for, and cost effect of changes in academic and support programs.*
- *Analysis of trends for executive, professional, technical, and clerical staffs.*
- *Special descriptions of items having major effect on the plan and operating budgets, such as fund-raising campaigns, new bond issues, appropriation expectations, library acquisitions, computing needs, utilities, and plant fund transfers.*

Report Nos. 3 and 4. A clear statement of the environmental assumptions used to create the long-range plan and budgets provides the governing board with information on the constraints and realities in the institution's operating environment. The environmental assumptions are both external and internal, and can be considered separately for the long-range plan or can include specific assumptions such as the amount of salary increase for the budget under consideration. Depending on the type of board activities, the board may approve and review those assumptions before developing the long-range plan

Report No. 4
Environmental Assumptions—Historical Data
Hybrid University

Student Retention

Graduation Class of	Percentage of original freshman class at Hybrid University who return as: Sophomores	Juniors	Seniors
1982	79.0%	61.6%	38.7%
1983	79.7	64.1	36.8
1984	80.0	65.8	37.0
1985	84.8	68.2	38.0
1986	83.2	66.6	
1987	82.1		

Student Fees

Year	Tuition	Percentage Increase	Cost-of-Living Increase
1981-82	$1,800	—	8.7%
1982-83	1,900	5.6%	4.3
1983-84	2,000	5.3	3.7
1984-85	2,100	5.0	(est.) 5.0

Selectivity of Admission Process

	A	B	C	D	E
Year	Applied	Admitted	Matriculated	(B/A)	(C/B)
1980-81	1,667	1,250	650	.75	.52
1981-82	1,655	1,059	625	.64	.59
1982-83	1,364	1,118	615	.82	.55
1983-84	1,341	1,167	630	.87	.54

and the current year's budget, or the board may review and approve them *concurrently* with approval of the budget. Because long-range plans are based on assumptions, such as inflation rates in future years, periodic reassessment is advised.

Some of the external and internal assumptions used by Hybrid University are contained in Report No. 3, while selected historical data are presented in Report No. 4.

Choice of historical data depends largely on the environmental assumptions selected for emphasis. Logical items might include:

- Tuition by sector (public and independent) and type of institution (such as Carnegie classification)
- Source of income
- Salary survey information
- Student/faculty ratio
- Tenured/total faculty ratio
- Educational and general expenditures per student
- Enrollments by sector (public and independent) and type of institution (such as Carnegie classification)

Report Nos. 5-11. The long-range plan provides the governing board with (1) information to assist it in evaluating the financial feasibility of the mission and goals, (2) information to evaluate the validity of the financially related policies it has approved, and (3) a framework for future decision making. In this context, the operating budget provides the opportunity for the board to (1) review and approve the acquisition and allocation of financial resources and (2) determine that proposed revenues and expenditures are compatible with the long-range plan.

The operating budget and long-range plan should be prepared annually (if the institution is on a biennial appropriation, frequency may be every two years), and should be based on three to five years of historical data. For certain types of information, such as gifts from private sources, longer trendlines might be appropriate. The long-range plan should contain projections for at least four years, the operating budget for the coming year, and the capital budget for the coming year as well as estimated cash flows for several succeeding years.

The presentation of the operating budget and long-range plan to the governing board is illustrated in Report Nos. 5-11. The first of these, No. 5, is the primary report, which is highly aggregated, showing general information and the assumptions used in preparing the operating budget and long-range plan (see Part A), estimated current funds revenues (see Part B), and estimated

Report No. 5(A)
Operating Budget and Long-Range Plan
Hybrid University
General Information

Item	Operating Data: Actual 1983-84	Operating Data: Projection 1984-85	Operating Data: Proposed Budget 1985-86	Planning Data: Plan 1986-87	Planning Data: Plan 1987-88	Planning Data: Plan 1988-89	Planning Data: Plan 1989-90	Supporting Rpt. No.
Students and Faculty								
Tuition rate	$ 2,000	$ 2,100*	$ 2,200	$ 2,300	$ 2,400	$ 2,500	$ 2,600	6
Total enrollment (headcount)	1,883	1,885*	1,882	1,884	1,886	1,887	1,886	
FTE enrollment	1,725	1,725*	1,725	1,725	1,725	1,726	1,725	6
FTE faculty	118	122*	115	110	104	98	92	
Student-faculty ratio (based on FTEs)	15:1	14:1*	15:1	16:1	17:1	18:1	19:1	
Number of students receiving degrees	230	225	250	240	240	230	240	
Number of students receiving financial aid	863	865*	865	865	865	865	865	
Average institutionally-based aid per FTE student	$ 74	$ 78*	$ 82	$ 86	$ 90	$ 95	$ 100	
Percentage increase	—	5.4%	5.1%	4.9%	4.7%	5.6%	5.3%	
Faculty compensation (total, in thousands)	$ 3,752	$ 4,075	$ 4,037	$ 4,059	$ 4,025	$ 3,979	$ 3,919	
Average faculty compensation	$31,800	$33,400	$35,100	$36,900	$38,700	$40,600	$42,600	
Percentage increase	—	5.0%	5.1%	5.1%	4.9%	4.9%	4.9%	
Staff								
Professional and administrative (FTE)	30	34*	38	36	36	36	36	
Clerical (FTE)	68	72*	76	77	72	72	72	
Other (FTE)	32	36*	38	36	36	36	36	
Student employees (FTE)	40	44*	42	40	40	40	40	
Total staff salaries, wages, and benefits (thousands)	$ 2,179	$ 2,524	$ 2,844	$ 2,902	$ 2,976	$ 3,121	$ 3,276	
Average staff salaries								
Professional and administrative	$24,500	$25,700	$27,000	$28,400	$29,800	$31,300	$32,800	
Clerical	12,100	12,700	13,300	14,000	14,700	15,400	16,200	
Other	17,400	18,300	19,200	20,100	21,200	22,200	23,300	
Students	1,600	1,750	1,850	1,950	2,050	2,150	2,250	
Endowment and Quasi-Endowment								
Market value (thousands)	$25,285	$26,549	$27,876	$29,270	$30,734	$32,271	$33,885	7
Yield on market value	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	7
Gifts (thousands)								
Current fund	$ 1,800	$ 1,835	$ 1,925	$ 2,020	$ 2,120	$ 2,230	$ 2,340	8
Endowment and similar funds	1,175	1,195	1,250	1,315	1,380	1,450	1,520	8
Plant fund	800	810	850	890	935	980	1,030	8
Student loan fund	135	150	155	160	170	180	190	8
Plant and Equipment								
Book value (thousands)	$45,000	$47,300	$49,700	$52,200	$54,800	$57,500	$60,400	
Square feet	380,000	380,000	380,000	380,000	380,000	380,000	380,000	

* *Actual fall 1984 figures. Note: This is a sample list; it is not intended to be all-inclusive.*

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current funds expenditures and transfers (see Part C). Revenues are listed by source, and expenditures are listed by function to match the format of the year-end statements.

The aggregated amounts are supported by more detailed reports, which include (in Report Nos. 6-9) revenue estimates for tuition and fees, endow-

Report No. 5(B)
Operating Budget and Long-Range Plan
Hybrid University
Revenues (thousands)

Item	Operating Data			Planning Data				
	Actual 1983-84	Projection 1984-85	Proposed Budget 1985-86	Plan 1986-87	Plan 1987-88	Plan 1988-89	Plan 1989-90	Supporting Rpt. No.
Tuition and fees	$ 3,650	$ 3,850	$ 4,040	$ 4,245	$ 4,455	$ 4,680	$ 4,910	6
Federal appropriations	650	690	720	760	795	835	890	
State appropriations	700	735	770	810	850	890	935	
Local appropriations	130	140	145	150	160	165	175	
Federal grants and contracts*	420	460	480	505	530	555	585	
State grants and contracts	35	30	35	30	35	35	35	
Local grants and contracts	30	25	25	25	30	35	30	
Private gifts, grants, and contracts	1,800	1,835	1,925	2,020	2,120	2,230	2,340	8
Endowment income	1,030	1,100	1,155	1,215	1,275	1,335	1,405	7
Sales and services of educational activities	250	275	290	305	320	335	350	
Other sources	40	30	40	40	40	45	40	
Subtotal	8,735	9,170	9,625	10,105	10,610	11,140	11,695	
Auxiliary enterprises	2,800	2,940	3,090	3,245	3,410	3,580	3,760	9
Total	$11,535	$12,110	$12,715	$13,350	$14,020	$14,720	$15,455	
Percentage increase		5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	
Breakdown by type of revenue								
Unrestricted	$10,035	$10,536	$11,062	$11,615	$12,197	$12,806	$13,446	
Restricted	1,500	1,574	1,653	1,735	1,823	1,914	2,009	

Revenue categories may be detailed as needed.
** Pell grants are not included.*

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Report No. 5(C)
Operating Budget and Long-Range Plan

Hybrid University
Current Funds Expenditures and Transfers (thousands)

Item	Operating Data			Planning Data				
	Actual 1983-84	Projection 1984-85	Proposed Budget 1985-86	Plan 1986-87	Plan 1987-88	Plan 1988-89	Plan 1989-90	Supporting Rpt. No.
Expenditures and mandatory transfers								
Educational and general								
Instruction	$ 4,920	$ 5,172	$ 5,432	$ 5,703	$ 5,987	$ 6,286	$ 6,601	10
Research	550	576	605	635	666	699	735	10
Public service	220	230	242	254	267	280	294	10
Academic support	315	329	345	363	381	400	420	10
Student services	255	271	285	299	314	330	346	10
Institutional support	605	633	665	698	733	769	808	10
Operation and maintenance of plant	510	549	585	624	665	708	752	10
Scholarships and fellowships*	255	271	285	299	314	330	346	10
Mandatory transfers	192	192	192	192	192	192	192	10
Subtotal	7,822	8,223	8,636	9,067	9,519	9,994	10,494	
Auxiliary enterprises	2,790	3,092	3,064	3,218	3,380	3,614	3,822	9
Total expenditures and mandatory transfers	$10,612	$11,315	$11,700	$12,285	$12,899	$13,608	$14,316	
Percentage increase		6.6%	3.4%	5.0%	5.0%	5.5%	5.2%	
Nonmandatory transfers and additions (deductions)								
Unrestricted gifts allocated to other funds	(650)	(800)	(800)	(800)	(800)	(800)	(800)	
Portion of quasi-endowment gains appropriated	40	—	—	—	—	—	—	
Other	25	—	—	—	—	—	—	
Increase (decrease) of net revenues	338	(5)	215	265	321	312	339	

Expenditure categories may be detailed as needed.
** Pell grants are excluded.*

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ment, gifts, and auxiliary enterprises; expenditures and transfers are supported by a report (No. 10) for academic and support departments. All these reports include information for the budget year under consideration and for future years, in appropriate detail for the board to understand the major components of revenue and expenditure. Projecting for future years, instead of presenting only the budget year under consideration, enables the board to identify the potential effect of its current decisions. For example, as demonstrated in Report No. 9, auxiliary enterprises is projected to operate at a deficit in future years.

Report No. 6
Projected Enrollment and Income from Tuition and Fees
Hybrid University

Enrollment (FTE)

Year	Freshman	Sophomore	Junior	Senior	Continuing Education	Total
1979-80*	645	490	400	252	38	1,825
1980-81*	618	498	385	248	41	1,790
1981-82*	596	478	393	240	43	1,750
1982-83*	571	470	386	252	46	1,725
1983-84*	570	475	384	249	48	1,725
1984-85*	568	478	381	247	51	1,725
1985-86	572	470	385	248	50	1,725
1986-87	570	463	394	250	48	1,725
1987-88	570	468	388	248	51	1,725
1988-89	569	472	383	248	53	1,725
1989-90	572	478	372	249	54	1,725

	1985-86	1986-87	1987-88	1988-89	1989-90
Enrollment (FTE)	1,725	1,725	1,725	1,726	1,725
Tuition rate	$ 2,200	$ 2,300	$ 2,400	$ 2,500	$ 2,600
Total tuition	$3,795,000	$3,967,500	$4,140,000	$4,315,000	$4,485,000
Student activity fees	$ 45,000	$ 47,500	$ 50,000	$ 55,000	$ 65,000
Summer school	200,000	230,000	265,000	310,000	360,000
Total tuition and fee income	$4,040,000	$4,245,000	$4,455,000	$4,680,000	$4,910,000
Percentage increase	———	5.1%	4.9%	5.1%	4.9%

** Data for prior years provided to show enrollment trends.*

Refer to the National Center for Education Statistics report "Projections of Education Statistics to 1990-91" and the American Council on Education's 1984-85 Fact Book on Higher Education *for further information.*

Consideration should be given to whether this operation should be self-sustaining. If so, the implementation of revenue-increasing measures, such as higher increases in charges for food services, or cost-cutting measures, such as decreased services, should be considered.

With this information the board now has an understanding of the external factors affecting the institution, the internal assumptions made by the institution, a review of the prior year's expenditures, a projection of the current year's expenditures, the budget for the coming year (with a detailed

Report No. 7
Projected Income from Endowment and Quasi-Endowment Funds
Hybrid University

	1985-86	1986-87	1987-88	1988-89	1989-90
Pooled Investments					
Total units	1,646 831	1,662,663	1,678,328	1,694,748	1,711,152
Unit value	$16.25	$16.90	$17.58	$18.28	$19.01
Earnings per unit	$ .66	$ .69	$ .71	$ .74	$ .77
Yield on market value	4.0%	4.0%	4.0%	4.0%	4.0%
Endowment					
(in thousands)					
Principal (market)	$18,956	$19,903	$20,899	$21,944	$23,042
Income	762	800	840	879	927
Term Endowment					
Principal (market)	3,066	3,220	3,381	3,550	3,727
Income	127	133	140	147	154
Quasi-Endowment					
Principal (market)	4,739	4,976	5,225	5,486	5,760
Income	196	206	216	227	238
Separately Invested					
Term Endowment					
Principal (market)	279	293	307	323	339
Income	12	13	14	15	16
Quasi-Endowment					
Principal (market)	836	878	922	968	1,017
Income	58	63	65	67	70
Total market value	$27,876	$29,270	$30,734	$32,271	$33,885
Percentage increase over prior year		5.0%	5.0%	5.0%	5.0%
Total income for budget	$ 1,155	$ 1,215	$ 1,275	$ 1,335	$ 1,405
Percentage increase over prior year		5.2%	4.9%	4.7%	5.2%

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development of revenues and expenditures), and projected plans for four additional years. This should give the board basic information with which to approve the budget, which is an expression in financial terms of the plans for operating the institution in the coming year. During this process the governing board must decide the following:

- Tuition rate
- Total amount available for compensation increases
- Endowment spending rate
- Amount to set aside for plant purposes
- Changes in existing academic programs

The capital budget (Report No. 11) is normally prepared at the same time as the annual operating budget, but because of the different focus — on capital needs — it is presented and reviewed separately.

Report No. 8
Projected Private Gifts, Grants, and Contracts
(in thousands)
Hybrid University

	1985-86	1986-87	1987-88	1988-89	1989-90
By Fund Group					
Current					
Unrestricted	$1,285	$1,355	$1,420	$1,495	$1,570
Restricted	640	665	700	735	770
Endowment and Similar					
Unrestricted	690	725	760	800	835
Restricted	375	395	415	435	455
Annuity and life income	185	195	205	215	230
Student Loan	155	160	170	180	190
Plant	850	890	935	980	1,030
Total	$4,180	$4,385	$4,605	$4,840	$5,080
Percentage increase		4.9%	5.0%	5.1%	5.0%
By Type of Donor					
Individuals					
Alumni	$2,550	$2,675	$2,810	$2,950	$3,100
Non-alumni	545	570	595	630	660
Bequests	125	130	140	145	150
Corporations	375	395	415	435	460
Foundations	585	615	645	680	710
Total	$4,180	$4,385	$4,605	$4,840	$5,080

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Report No. 9
Projected Auxiliary Enterprise Income
(in thousands)
Hybrid University

	1985-86	1986-87	1987-88	1988-89	1989-90
Residence Halls					
Income	$1,668	$1,752	$1,842	$1,933	$2,030
Expense	1,329	1,411	1,497	1,649	1,773
Mandatory transfers					
Debt service	250	250	250	250	250
Renewals and replacements	70	70	70	70	70
Net	19	21	25	(36)	(63)
Food Services					
Income	1,3[illegible]	1,395	1,466	1,539	1,617
Expense	1,32[illegible]	1,391	1,463	1,537	1,616
Net	5	4	3	2	1
Other Services					
Income	93	98	102	108	113
Expense	91	96	100	108	113
Net	2	2	2	—	—
Total income	$3,090	$3,245	$3,410	3,580	$3,760
Total expense	2,744	2,898	3,060	3,294	3,502
Total mandatory transfers	320	320	320	320	320
Total expense and mandatory transfers	3,064	3,218	3,380	3,614	3,822
Net	2[illegible]	27	30	(34)	(62)
Projected Room and Board Rates					
Room	$1,060	$1,115	$1,170	$1,230	$1,290
Board	980	1,025	1,080	1,135	1,195
Total	$2,040	$2,140	$2,250	$2,365	$2,485
Percentage increase	—	4.9%	5.1%	5.1%	5.1%
Other Projected Data					
Number of residents	1,425	1,425	1,400	1,410	1,415
Number of food service contracts	1,475	1,500	1,510	1,490	1,500
Design capacity	1,650	1,650	1,650	1,650	1,650
Occupancy rate	86%	86%	86%	86%	86%

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Report No. 10
Estimated Expenditures and Mandatory Transfers for Academic and Support Departments (in thousands)

Hybrid University

Educational and General	1985-86	1986-87	1987-88	1988-89	1989-90	Compound Growth Rate
Instruction						
Business Administration	$1,630	$1,711	$1,797	$1,886	$ 1,980	
Continuing Education	815	855	898	943	990	
Engineering	1,141	1,198	1,257	1,320	1,386	
Liberal Arts	1,575	1,654	1,736	1,823	1,915	
Other	271	285	299	314	330	
Total	5,432	5,703	5,987	6,286	6,601	5%
Research						
Business Administration	345	362	380	398	419	
Continuing Education	42	44	46	49	51	
Engineering	218	229	240	252	265	
Total	605	635	666	699	735	5%
Public Service						
Business Administration	194	203	214	224	235	
Continuing Education	48	51	53	56	59	
Total	242	254	267	280	294	5%
Academic Support	345	363	381	400	420	5%
Student Services	285	299	314	330	346	5%
Institutional Support	665	698	733	769	808	5%
Operation and Maintenance of Plant	585	624	665	708	752	7%
Scholarships and Fellowships	285	299	314	330	346	5%
Total expenditures	$8,444	$8,875	$9,327	$9,802	$10,302	$5%
Mandatory Transfers						
Principal and Interest	90	90	90	90	90	
Renewals and Replacements	100	100	100	100	100	
Loan Fund Matching Grant	2	2	2	2	2	
Total mandatory transfers	192	192	192	192	192	0%
Total expenditures and mandatory transfers	$8,636	$9,067	$9,519	$9,994	$10,494	5%
Percentage increase		5.0%	5.0%	5.0%	5.0%	

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Report No. 11
Capital Budget (in thousands)
Hybrid University

Cash Flow

	Estimated Completion Date	Estimated Project Cost	To Date	Current Year	Proposed for Budget Year
Projects Under Construction					
Renovation-Olde Hall	Apr 1986	$ 4,685	$3,160	$1,090	$ 480
Renovation-Gnew Dorm	Aug 1987	1,130	190	470	250
Renovation-Steam Plant	Dec 1989	2,865	500	255	360
		$ 8,680	$3,850	$1,815	$1,090
Fund Sources					
State Grants		6,165	2,865	145	1,690
Federal Grants		260	150	145	35
Note Payable*		1,475	1,460	—	—
Gifts		345	250	75	35
Plant Fund Reserves		435	300	70	—
		$ 8,680	$5,025	$ 435	$1,760
Cumulative Net Cash Flow			+$1,175	−$1,380	+$ 670
Proposed Projects					
Renovation-Thomas Hall	Aug 1989	$6,145			$2,095
Renovation-Richards Gym	Apr 1990	4,165			1,100
Renovation-Harrison Quad	Sep 1991	6,520			355
		$19,830	$ -0-	$ -0-	$3,550
Fund Sources					
State Grants		$ 1,390		$ -0-	$ 380
Federal Grants		795		-0-	125
Bond Payable		10,905		3,650	3,615
Gifts		2,975		1,060	1,080
Plant Fund Reserves		3,765		1,175	1,145
		$19,830		$5,885	$6,345
Cumulative Net Cash Flow for Proposed Projects				+$5,885	+$2,795
Projects Anticipated but Not Programmed (in priority order)					
Chilled-Water System		$5,020			
Fire Station		1,860			
Renovation-Alpine Hall		7,810			
Renovation-Zephyr Wing		3,905			
		$18,595			

**Payable from residence hall revenues*

Supporting this report would be the detail for funding sources of each project, a description of the status of projects under construction, and a description and justification for proposed projects.

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Report No. 12
Statement of Operations and Variance Analysis

Six Months Ended December 31, 1984 (in thousands)
Hybrid University

	Jul 1-Dec 31		Year 1984-85			
	Budget	Actual	Budget	Projection	Variance	Reference
Revenues						
Tuition and fees	$1,875	$1,890	$3,890	$3,840	$ 50	A
Federal appropriations	345	325	690	690	—	
State appropriations	370	385	735	735	—	
Local appropriations	70	55	140	140	—	
Federal grants and contracts	230	240	460	460	—	
State grants and contracts	15	10	30	30	—	
Local grants and contracts	15	20	25	25	—	
Private gifts, grants, and contracts	1,130	1,415	1,625	1,835	210	B
Endowment income	575	540	1,150	1,100	(50)	C
Sales and services of educational activities	135	135	275	275	—	
Other sources	15	15	30	30	—	
Subtotal	4,775	5,030	8,960	9,170	210	
Expenditures and Mandatory Transfers (Educational and General)						
Instruction	$2,560	$2,578	$5,155	$5,172	17	A
Research	290	303	576	576	—	
Public service	115	119	230	230	—	
Academic support	165	162	329	329	—	
Student services	135	142	271	271	—	
Institutional support	315	310	633	633	—	
Operation and maintenance of plant	240	280	484	549	65	D
Scholarships and fellowships	205	170	257	271	14	A
Mandatory transfers, educational and general	100	100	192	192	—	
Subtotal	$4,125	$4,164	$8,127	$8,223	96	
Excess (deficit)	650	866	833	947	114	
Auxiliary Enterprise Revenues	$1,425	$1,479	$2,845	$2,940	95	A
Auxiliary Enterprise Expenditures and Mandatory Transfers	1,420	1,477	2,840	2,920	80	A
Excess (deficit)	5	2	5	20	15	
Nonmandatory Transfers	350	350	700	700	—	
Excess (deficit)	$ 305	$ 518	$ 138	$ 267	$129	

Continued on next page

The above format is intended to be representative only of the principle that the governing board should be aware of how actual results compare to the budget and of the reasons for major variances. Many other report formats and financial information accomplish the same purpose. Comparison with prior years, use of percentage analysis, and analysis by responsibility center are some of the more frequently used methods for advising the board of actual performance.

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Operating Reports

Report Nos. 12-14. Once all budgets are approved, the institution is able to move forward and operate, but it is still necessary that the board have periodic reviews during the year of actual performance relating to the plan. Such reviews can be based on a series of statements of operations and variance analyses. Although frequency would depend on board preference, differences in institutional requirements, and number of board meetings, these reports would normally be presented quarterly, but if the executive committee or finance committee meets monthly, they may be presented monthly. These reports enable the board to be kept informed of whether the plan, as reflected in the annual budget, is being followed.

The purpose of the Statement of Operations and Variance Analyses (Report No. 12) is to provide the governing board with the opportunity to (1) review the financial operations of the institution, (2) assure itself that the budget is being followed, and (3) see that variances are analyzed and documented. The statement should contain the original budget approved by the board, estimate of actual performance for the year, and expected variance. As in

Report No. 12 *(cont.)*
Explanation of Variances
Hybrid University

Reference	
A. Tuition and fees	+$50,000
Instruction	+ 17,000
Scholarships and fellowships	+ 14,000
Auxiliary enterprises	
Revenues	+ 95,000
Expenditures	+ 80,000

Tuition income for the fall term is $15,000 above the estimate, due to an actual student enrollment that was greater than anticipated. The original fall enrollment projection was 1,700 FTE; actual enrollment was 1,725. Based on the higher enrollment, it is projected that winter- and spring-quarter enrollments will also increase slightly, causing a total variance of $50,000. In addition, part-time instructors were hired ($17,000) and scholarships awarded ($14,000) due to increased enrollments.

The increase in auxiliary enterprise revenues and expenditures is also due to the increased number of students.

B. Private gifts, grants, and contracts +$210,000

The university received in December an anonymous gift. The gift is unrestricted and a recommendation for its use will be made at the March 1985 board meeting.

C. Endowment income −$50,000

The original budget estimate projected a yield of 4.5 percent; the current projection is that it will be closer to 4 percent of market value. This will create a downward adjustment of approximately $50,000.

D. Operation and maintenance of plant +$65,000

The increase in rates by the local utility, coupled with the severe winter, caused an increase in the electricity bill. The total increase is estimated at $65,000.

Report No. 5, revenues are listed by source and expenditures are listed by function.

The next two reports, "Development Program" and "Investment Performance" (Report Nos. 13 and 14), are examples of reports that supplement the statement of operations and the variance analysis. Such reports can be designed for other revenue sources as well as for expenditures; the amount of detail would depend on board preference.

Report No. 13
Development Program
Summary Report for the Six Months Ended December 31, 1984
(in thousands)
Hybrid University

	1983-84 Total	1984-85 Goal	Amount Received This Six-Month Period	Amount Received Same Six-Month Period Last Year
Source				
Individuals				
Alumni	$1,370	$1,595	$1,220	$1,495
Non-alumni	470	680	450	410
Foundations	705	955	450	440
Corporations	390	520	255	235
Bequests	975	240	830	355
Total	$3,910	$3,990	$3,205	$2,935
Purpose				
Current				
Unrestricted	$ 990	$ 935	$ 890	$1,020
Restricted	810	900	855	830
Student Loan	135	150	70	60
Endowment	1,175	1,195	750	910
Plant	800	810	640	115
Total	$3,910	$3,990	$3,205	$2,935

The annual alumni fund drive is expected to achieve its goal for the year. Giving from foundations and business corporations is as anticipated. The receipt of a $150,000 gift from an anonymous donor in December is expected to place total giving from all donors for the year in excess of the goal.

Report No. 14
Investment Performance

(in thousands)
Hybrid University

Types of Investments

	Dec. 31, 1984		Dec. 31, 1983	
	Market Value	Percent	Market Value	Percent
Common stocks	$19,455	57%	$15,245	58%
Short-term investments	2,730	8	2,105	8
Other corporate notes and bonds	9,560	28	7,355	28
U.S. government obligations	680	2	525	2
Real estate	680	2	525	2
Mortgage notes receivable	1,025	3	525	2
Total	$34,130	100%	$26,280	100%

Market Values and Income per Unit

Date	Market Value	Income
December 31, 1984	$15.75	$.64
June 30, 1984	15.00	.59
December 31, 1983	13.75	.55

Summary of Investment Performance

	Year Ended December 31, 1984		
	Rate of Yield	Market Price Change	Total Return
Pooled Endowment Funds	4.2%	6.3%	10.1%

This is representative of only some of the information important for examining investment performance. Refer to NACUBO's booklet "Reporting on Investments of Endowment Funds" and to the annual "NACUBO Comparative Performance Study and Investment Questionnaire" for further information.

Results of Operations

Report Nos. 15-18. At the end of the year, after being presented with the long-range plan, budget for the year, and operating reports, the board needs to be informed of results of operations. The statements are similar to and consistent with those prepared in accordance with generally accepted accounting principles, but have been modified for presentation to the board; the modification is designed to help the board in its review of operations for the year. As well as being a review of the year's operations, this can also be the first step in understanding the institution's finances as the board moves into the next year, in which the cycle of updating the assumptions and long-range plan and of preparing a new annual budget will occur.

The governing board must assure itself that resources entrusted to it are

Report No. 15
Balance Sheet
June 30, 1984
with comparative figures at June 30, 1983
(in thousands)
Hybrid University

	Current	Loan	Endowment & Similar	Plant	Total Current Year	Total Prior Year
Current Assets						
Cash	$ 590			$ 110	$ 700	$ 303
Investments	977				977	757
Accounts receivable	427				427	488
Inventories and prepaid expenses	265				265	135
(Due to) Due from other funds	(224)	$ 4		222	2	
Subtotal	2,035	4		332	2,371	1,683
Current Liabilities						
Accounts payable and accrued liabilities	273			13	286	223
Unearned (deferred) revenue	42				42	28
Portion of long-term debt due within one year				319	319	314
Deposits held in custody for others	155				155	132
Subtotal	470			332	802	697
Net current assets	1,565	4		0	1,569	986

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(1) under adequate control, (2) prudently managed, and (3) either protected or expended in accordance with the requirements of the initial providers. The board also has the responsibility of reconciling obligations made in the past with present needs as well as future requirements. The annual financial reports

Report No. 15 *(cont.)*
Balance Sheet
June 30, 1984
with comparative figures at June 30, 1983
(in thousands)
Hybrid University

	Current	Loan	Endowment & Similar	Plant	Total Current Year	Total Prior Year
Long-term Assets						
Cash		38	$ 276	567	881	862
Investments		144	27,350	1,888	29,382	26,728
Loans receivable		776			776	437
Deposits with trustees				504	504	425
Land, buildings, and equipment				59,989	59,989	57,766
Subtotal		958	27,626	62,948	91,532	86,218
Long-term Liabilities						
Annuities payable			3,070		3,070	3,197
Notes, bonds, and mortgages payable				5,293	5,293	4,795
Subtotal			3,070	5,293	8,363	7,992
Net long-term assets		958	24,556	57,655	83,169	78,226
Net assets	$1,565	$962	$24,556	$57,655	$84,738	$79,212
Fund Balances						
Unrestricted—not designated	685				685	665
Unrestricted—designated	161	212		576	949	919
Restricted	719	683		1,730	3,132	3,961
U.S. government grants refundable		67			67	42
Endowment			11,050		11,050	9,505
Term endowment			5,402		5,402	4,753
Quasi-endowment						
Unrestricted			1,473		1,473	792
Restricted			1,965		1,965	1,584
Annuity and life income			4,666		4,666	3,961
Investment in plant				55,349	55,349	53,030
Total fund balances	$1,565	$962	$24,556	$57,655	$84,738	$79,212

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Report No. 16
Statement of Changes in Fund Balances

Year Ended June 30, 1984
with comparative figures at June 30, 1983
(in thousands)
Hybrid University

Current				
Unrestricted				
Not Designated	Designated	Restricted	Total	
				Revenues and other additions
$3,761	$3,162		$6,923	Students
1,842			1,842	Appropriations
77		$ 723	800	Government grants and contracts
1,228		535	1,763	Private gifts, grants, and contracts
461		314	775	Investments
230			230	Sales and services
76			76	Expired term endowment and other sources
7,675	**3,162**	**1,572**	**12,409**	**Total revenues and other additions**
				Expenditures and other deductions
6,330	2,790	1,345	10,465	Operating expenditures
				Plant expenditures
				Retirement of debt
				Interest on indebtedness
		25	25	Expired term endowment and other
6,330	**2,790**	**1,370**	**10,490**	**Total expenditures and other deducations**
				Other changes
				Additions to plant facilities
				Disposals and retirements
				Mandatory transfers
	(487)		(487)	Principal and interest
(242)			(242)	Renewals and replacements
(3)			(3)	Loan fund matching requirement
				Nonmandatory transfers
(1,023)	83		(940)	Unrestricted gifts allocated
60			60	Quasi-endowment investment gains allocated
(1,208)	(404)		(1,612)	**Total other changes**
137	(32)	202	307	Net increase (decrease) for the year
548	193	517	1,258	Fund balance at beginning of year
$ 685	$ 161	$ 719	$1,565	**Fund balance at end of year**

provide useful information for carrying out these responsibilities. At least two fiscal years should be covered by these annual reports, the most current and the one previous.

The authoritative references recommend three such reports: Balance

Student Loans	Endowment and Similar	Plant Total		Total		Percentage Change
		Unexpended	Invested in Plant	Current Year	Prior Year	
				$ 6,923	$ 6,637	4.3%
		$ 80		1,922	1,901	1.1
$ 22				822	792	3.8
118	$ 3,250	285	$ 83	5,499	5,227	5.2
27	227	55		1,084	1,056	2.7
				230	225	2.2
	17	80		173	5	N/A
167	3,494	500	83	16,653	15,843	5.1
				10,465	10,267	1.9
		2,088		2,088	1,774	17.8
		321		321	253	26.9
		266		266	253	5.1
68	270	2		365	127	87.4
68	270	2,677		13,585	12,674	6.6
			2,543	2,543	1,733	46.7
			(165)	(165)	(149)	(10.7)
		487				
		242				
3						
68	872					
	(60)					
71	812	729	2,378	2,378	1,584	50.1%
170	3,961	(1,373)	2,461	5,526	4,753	
792	20,595	3,961	52,606	79,212	74,459	
$962	$24,556	$2,588	$55,067	$84,738	$79,212	

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Report No. 17
Statement of Current Funds Expenditures

Year Ended June 30, 1984
(in thousands)
Hybrid University

	Unrestricted					
	Not Designated	Designated	Restricted	Total	Prior Year Total	Percentage Change
Educational and General						
Instruction						
Business Administration	$1,269		$ 48	$ 1,328	$1,247	6.5%
Continuing Education	592		179	787	785	0.3
Engineering	804		324	1,132	1,063	6.5
Liberal Arts	1,396		35	1,427	1,294	10.3
Other	169		104	246	231	6.5
Total	4,230		690	4,920	4,620	6.5
Research						
Business Administration	110		136	246	161	52.8
Continuing Education			44	44	27	63.0
Engineering			260	260	267	(2.6)
Other					80	
Total	110		440	550	535	2.8
Public Service						
Business Administration	185			185	130	42.3
Continuing Education			35	35	75	(53.3)
Total	185		35	220	205	7.3
Academic Support	315			315	305	3.3
Student Services	255			255	245	4.1
Institutional Support	605			605	575	5.2
Operation and Maintenance of Plant	510			510	440	15.9
Scholarships and Fellowships	120		135	255	240	6.3
Total Educational and General Expenditures	6,330		1,300	7,630	7,165	6.5
Auxiliary Enterprises Expenditures		2,790		2,790	2,710	3.0
Total Expenditures	$6,330	$2,790	$1,300	$10,420	$9,875	5.5%

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Sheet, Statement of Changes in Fund Balances, and Statement of Current Funds Revenues, Expenditures, and Other Changes. In addition, two other reports are suggested: Statement of Current Funds Expenditures and a Statement of Historical Changes in Fund Balances (see Report Nos. 17 and 18). It should be noted that no attempt is made in this explanation to include the accompanying notes to the financial statements; these will be found in the Illustrative Exhibits following this chapter.

Report No. 18
Statement of Historical Changes in Fund Balances
(in thousands)
Hybrid University

	1979-80	1980-81	1981-82	1982-83	1983-84
Current					
Unrestricted—not designated	$ 472	$ 518	$ 574	$ 631	$ 685
Unrestricted—designated	107	118	130	144	161
Restricted	493	542	600	660	719
	1,072	1,178	1,304	1,435	1,565
Loan					
Designated	144	158	175	193	212
Restricted	465	512	566	623	683
U.S. government grants refundable	46	50	56	61	67
	655	720	797	877	962
Endowment and Similar					
Endowment	7,774	8,543	9,457	9,457	11,050
Term endowment	3,800	4,176	4,623	4,623	5,402
Quasi-endowment					
Unrestricted	1,382	1,519	1,681	1,681	1,965
Restricted	1,036	1,139	1,261	1,261	1,473
Annuity and life income	3,282	3,607	3,993	3,993	4,666
	17,274	18,984	21,015	23,116	24,556
Plant					
Unexpended—designated	406	[illegible]	493	543	576
Unexpended—restricted	1,217	1,337	1,480	1,629	1,730
Investment in plant	38,940	42,796	47,375	52,113	55,349
	40,563	44,579	49,349	54,284	57,655
Total	$59,564	$65,461	$72,465	$79,712	$84,738

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Balance Sheet. This statement shows the assets, liabilities, and accumulated balances on a given date for each of the four funds described (see Report No. 15). It serves the same purpose as a corporate balance sheet; information on debt, working capital, and fund balances can indicate whether the institution is financially healthy. An important distinction of this balance sheet compared to a corporate balance sheet is the separation of fund balances into the groups described above. As with the Statement of Changes in Fund Balances, totals are provided for both the current and previous years.

Statement of Changes in Fund Balances. This statement (Report No. 16) shows how the financial activity for the year has affected each of the fund groups: Current, Student Loan, Endowment and Similar, and Plant. It addresses three primary issues discussed in this monograph:

- How were the financial resources generated?
- How were they spent?
- How were they managed and protected?

The statement is divided into three sections, each providing an answer to the above questions:

The "revenues and other additions" section brings together all the financial resources received by the institution and classifies them by purpose (fund) and restriction. The resources are also grouped according to source such as students and appropriations.

The "expenditures and other deductions" section summarizes how the financial resources were spent from each of the fund groups. A more detailed analysis of the current fund expenditures is provided in the Statement of Current Funds Expenditures (Report No. 17).

The "other changes" section shows how the financial resources were managed and protected. It is here that the fund balances are adjusted in accordance with actions taken by the governing board to reflect the institution's financial condition. For example, if the institution had to pay for current operations from funds the board had previously designated as quasi-endowment, a transfer would be shown *from* endowment and similar funds *to* current funds. Conversely, if the governing board were in a position to save or invest current revenues for the future, a transfer would be made *from* current funds *to* endowment and similar funds. A similar transfer is made when the board decides to spend current revenues for a new building or major renovation. In this case, a transfer is made *from* current funds *to* plant funds — unexpended. By closely examining the transfers and ending fund balances, trustees can see the net effect of their prior decisions on the financial status of the institution.

The Statement of Changes in Fund Balances concludes by showing the

net increase or decrease in each fund group and the balances at the end of the year. The fund groups can be totaled and compared with the total amounts from the prior year, as they are in Report No. 15.

Statement of Current Funds Expenditures. This statement shows expenditures for the three subheadings in the current funds column: unrestricted — not designated, unrestricted — designated, and restricted (see Report No. 17). Expenditures are grouped by function or program activity (such as instruction, research, and public service), with the first three functions further subdivided into academic units.

Statement of Historical Changes in Fund Balances. This statement provides a historical perspective of the financial status of the institution by displaying fund balances for five years for each fund group (see Report No. 18). This provides an important context for evaluating the present financial status of the institution.

External Auditor's Report

The final step in this annual process of maintaining financial responsibility and financial approval is the presentation of a statement prepared by external audits, either state auditors or a public accounting firm. This annual audit is prepared in accordance with generally accepted accounting principles that (1) have been approved by the American Institute of Certified Public Accountants in its industry audit guide, *Audits of Colleges and Universities* (1975), (2) have been promulgated by the industry (in this case, higher education) in NACUBO's *College & University Business Administration* (4th ed., 1982), (3) have been adopted by the National Center for Education Statistics for financial reporting to the federal government, and (4) are compatible with the program classification structure developed by the National Center for Higher Education Management Systems.

Formats of the annual audited report are included in the next section, Illustrative Exhibits. These formats, which primarily reflect fiduciary responsibility, are not identical to those presented in Report Nos. 15-18.

This final step, the audited report, is very important because it enables the board to know, from a source external to the institution, that the annual financial reports, as provided by management, have been reviewed by an external independent body. The management letter, which accompanies the audited report, assures the trustees that not only are the figures accurate, but that the accounting systems are reliable.

Self-Evaluation

The above description completes the basic cycle that is necessary in all institutions. There are many other reports that might be needed and that should be used, depending on the type of institution, interest of the board, and priorities of problems that must be addressed on a continuing basis or at a particular time. Such additional reports may include those on cash flow, sponsored projects, insurance coverage, outstanding debt obligations, and unit costs of instruction. Although many more could be added, it is hoped that the ones presented here will provide a basis for the governing board to decide what reports will be most useful to it in planning the institution's future.

This monograph emphasizes "best practice" in defining the financial responsibilities of governing boards and the ways financial information may be presented. It is recognized that the "best practice" approach presented here might appear overwhelming. What is important, however, is to be assured that the board is carrying out its financial responsibilities in maintaining the institution's mission while incurring a prudent level of risk.

It is assumed that the "best practices" described in this monograph could be of benefit to most colleges and universities; there should be some method by which the proposed concepts are examined, tested, and evaluated to determine their merit at a particular institution.

This can be done. A recommended method is for the chairperson of the board, the president, and the chief business officer initially to review the monograph and to determine its merit for the institution. In fact, the monograph could serve as a checklist to determine how effectively the institution is communicating with the board. Based on the initial observations, one or more of the following decisions might be made:

- No action is required because present policies and practices are satisfactory.
- Certain policies and/or practices should be altered immediately.
- Other issues will require further study.

For the issues requiring further study, the chairperson of the board and the president may wish to appoint a self-evaluation panel. This panel could be charged with comparing the institution's financial policies and information systems with those outlined in the monograph. The panel should have broad representation to ensure a variety of participation in the evaluation process. Major variances should be noted and analyzed to determine if any policies and practices should be changed. The chief business officer can be helpful

in evaluating current reporting practices and in suggesting to the panel possible areas for improvement.

There will be many instances where existing policies and practices will be superior to those contained in the monograph because they are tailored to the specific traditions, characteristics, and needs of the institution. Even for these institutions this monograph should serve as a stimulus for improved governance.

Illustrative Exhibits

The figures used in the accompanying exhibits are illustrative only and are not intended to indicate any relationship among accounts. The summary of significant accounting policies and the notes to financial statements relate to the illustrative statements. Modifications should be made thereto as appropriate to actual circumstances.

Material from the industry audit guide, *Audits of Colleges and Universities*, copyright ©1975 by the American Institute of Certified Public Accountants, and from *College & University Business Administration*, copyright 1982 by NACUBO, is adapted with permission.

Exhibit A
Balance Sheet

June 30, 19_____
with comparative figures at June 30, 19_____
Hybrid University

Assets	Current Year	Prior Year	Liabilities and Fund Balances	Current Year	Prior Year
Current Funds			**Current Funds**		
Unrestricted			**Unrestricted**		
Cash	$ 210,000	$ 110,000	Accounts payable	$ 125,000	$ 100,000
Investments	450,000	360,000	Accrued liabilities	20,000	15,000
Accounts receivable, less allowance of $18,000 both years	228,000	175,000	Students' deposits	30,000	35,000
			Due to other funds	158,000	120,000
Inventories, at lower of cost (first-in, first-out basis) or market	90,000	80,000	Deferred credits	30,000	20,000
			Fund balance	643,000	455,000
Prepaid expenses and deferred charges	28,000	20,000			
Total unrestricted	1,006,000	745,000	Total unrestricted	1,006,000	745,000
Restricted			**Restricted**		
Cash	145,000	101,000	Accounts payable	14,000	5,000
Investments	175,000	165,000	Fund balance	446,000	421,000
Accounts receivable, less allowance of $8,000 both years	68,000	160,000			
Unbilled charges	72,000	—			
Total restricted	460,000	426,000	Total restricted	460,000	426,000
Total current funds	1,466,000	1,171,000	Total current funds	1,466,000	1,171,000
Loan Funds			**Loan Funds**		
Cash	30,000	20,000	Fund Balances		
Investments	100,000	100,000	U.S. government grants refundable	50,000	33,000
Loans to students, faculty, and staff, less allowance of $10,000 current year and $9,000 prior year	550,000	382,000	University funds		
			Restricted	483,000	369,000
			Unrestricted	150,000	100,000
Due from unrestricted funds	3,000	—			
Total loan funds	683,000	502,000	Total loan funds	683,000	502,000
Endowment and Similar Funds			**Endowment and Similar Funds**		
Cash	100,000	101,000	Fund balances		
Investments	13,900,000	11,800,000	Endowment	7,800,000	6,740,000
			Term endowment	3,840,000	3,420,000
			Quasi-endowment—unrestricted	1,000,000	800,000
			Quasi-endowment—restricted	1,360,000	941,000
Total endowment and similar funds	14,000,000	11,901,000	Total endowment and similar funds	14,000,000	11,901,000

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Exhibit A
Balance Sheet (continued)

June 30, 19_____
with comparative figures at June 30, 19_____
Hybrid University

Assets			Liabilities and Fund Balances		
Annuity and Life Income Funds			**Annuity and Life Income Funds**		
	Current Year	**Prior Year**		**Current Year**	**Prior Year**
Annuity funds			**Annuity funds**		
Cash	$ 55,000	$ 45,000	Annuities payable	$ 2,150,000	$ 2,300,000
Investments	3,260,000	3,010,000	Fund balances	1,165,000	755,000
Total annuity funds	3,315,000	3,055,000	Total annuity funds	3,315,000	3,055,000
Life income funds			**Life income funds**		
Cash	15,000	15,000	Income payable	5,000	5,000
Investments	2,045,000	1,740,000	Fund balances	2,055,000	1,750,000
Total life income funds	2,060,000	1,755,000	Total life income funds	2,060,000	1,755,000
Total annuity and life income funds	5,375,000	4,810,000	Total annuity and life income funds	5,375,000	4,810,000
Plant Funds			**Plant Funds**		
Unexpended			**Unexpended**		
Cash	275,000	410,000	Accounts payable	10,000	—
Investments	1,285,000	1,590,000	Notes payable	100,000	—
Due from unrestricted current funds	150,000	120,000	Bonds payable	400,000	—
			Fund balances		
			Restricted	1,000,000	1,860,000
			Unrestricted	200,000	260,000
Total unexpended	1,710,000	2,120,000	Total unexpended	1,710,000	2,120,000
Renewals and replacements			**Renewals and replacements**		
Cash	5,000	4,000	Fund balances		
Investments	150,000	286,000	Restricted	25,000	180,000
Deposits with trustees	100,000	90,000	Unrestricted	235,000	200,000
Due from unrestricted current funds	5,000	—			
Total renewals and replacements	260,000	380,000	Total renewals and replacements	260,000	380,000
Retirement of indebtedness			**Retirement of indebtedness**		
Cash	50,000	40,000	Fund balances		
Deposits with trustees	250,000	253,000	Restricted	185,000	125,000
			Unrestricted	115,000	168,000
Total retirement of indebtedness	300,000	293,000	Total retirement of indebtedness	300,000	293,000
Investment in plant			**Investment in plant**		
Land	500,000	500,000	Notes payable	790,000	810,000
Land improvements	1,000,000	1,110,000	Bonds payable	2,200,000	2,400,000
Buildings	25,000,000	24,060,000	Mortgages payable	400,000	200,000
Equipment	15,000,000	14,200,000	Net investment in plant	38,210,000	36,540,000
Library books	100,000	80,000			
Total investment in plant	41,600,000	39,950,000	Total investment in plant	41,600,000	39,950,000
Total plant funds	43,870,000	42,743,000	Total plant funds	43,870,000	42,743,000
Agency Funds			**Agency Funds**		
Cash	50,000	70,000	Deposits held in custody for others	110,000	90,000
Investments	60,000	20,000			
Total agency funds	110,000	90,000	Total agency funds	110,000	90,000

See accompanying Summary of Significant Accounting Policies and Notes to Financial Statements

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Exhibit B
Statement of Changes in Fund Balances
Year Ended June 30, 19_____
Hybrid University

	Current Funds		Loan Funds	Endowment and Similar Funds	Annuity and Life Income Funds	Plant Funds			
	Unrestricted	Restricted				Unexpended	Renewals and Replacements	Retirement of Indebtedness	Investment in Plant
Revenues and Other Additions									
Unrestricted current fund revenues	$7,540,000								
Expired term endowment—restricted						$ 50,000			
State appropriations—restricted						50,000			
Federal grants and contracts—restricted		$ 500,000							
Private gifts, grants, and contracts—restricted		370,000	$100,000	$1,500,000	$800,000	115,000		$65,000	$ 15,000
Investment income—restricted		224,000	12,000	10,000		5,000	$ 5,000	5,000	
Realized gains on investments—unrestricted				109,000					
Realized gains on investments—restricted			4,000	50,000		10,000	5,000	5,000	
Interest on loans receivable			7,000						
U.S. government advances			18,000						
Expended for plant facilities (including $100,000 charged to current funds expenditures)									1,550,000
Retirement of indebtedness									220,000
Accrued on sale of bonds								3,900	
Matured annuity and life income restricted to endowment				10,000					
Total revenues and other additions	7,540,000	1,094,000	141,000	1,679,000	800,000	230,000	10,000	78,000	1,785,000

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Statement of Changes in Fund Balances (continued)

Year Ended June 30, 19_____
Hybrid University

	Current Funds		Loan Funds	Endowment and Similar Funds	Annuity and Life Income Funds	Plant Funds			
	Unrestricted	Restricted				Unexpended	Renewals and Replacements	Retirement of Indebtedness	Investment in Plant
Expenditures and Other Deductions									
Educational and general expenditures	4,400,000	1,014,000							
Auxiliary enterprises expenditures	1,830,000								
Indirect costs recovered		35,000							
Refunded to grantors		20,000	10,000						
Loan cancellations and write-offs			1,000						
Administrative and collection costs			1,000					1,000	
Adjustment of actuarial liability for annuities payable					75,000				
Expended for plant facilities (including noncapitalized expenditures of $50,000)						1,200,000	300,000		
Retirement of indebtedness								220,000	
Interest on indebtedness								190,000	
Disposal of plant facilities									115,000
Expired term endowments ($40,000 unrestricted, $50,000 restricted to plant)				90,000					
Matured annuity and life income funds restricted to endowment				10,000					
Total expenditures and other deductions	6,230,000	1,069,000	12,000	90,000	85,000	1,200,000	300,000	411,000	115,000

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Statement of Changes in Fund Balances (continued)

Year Ended June 30, 19_____
Hybrid University

	Current Funds		Loan Funds	Endowment and Similar Funds	Annuity and Life Income Funds	Plant Funds			
	Unrestricted	Restricted				Unexpended	Renewals and Replacements	Retirement of Indebtedness	Investment in Plant
Transfers Among Funds—Additions/(Deductions)									
Mandatory:									
Principal and interest	(340,000)							340,000	
Renewals and replacements	(170,000)						170,000		
Loan fund matching grant	(2,000)		2,000						
Unrestricted gifts allocated	(650,000)		50,000	550,000		50,000			
Portion of unrestricted quasi-endowment funds investment gains appropriated	40,000			(40,000)					
Total transfers	(1,122,000)		52,000	510,000		50,000	170,000	340,000	
Net increase/ (decrease) for the year	188,000	25,000	181,000	2,099,000	715,000	(920,000)	(120,000)	7,000	1,670,000
Fund balance at beginning of year	455,000	421,000	502,000	11,901,000	2,505,000	2,120,000	380,000	293,000	36,540,000
Fund balance at end of year	643,000	446,000	683,000	14,000,000	3,220,000	1,200,000	260,000	300,000	38,210,000

See accompanying Summary of Significant Accounting Policies and Notes to Financial Statements

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Exhibit C
Statement of Current Funds Revenues, Expenditures, and Other Changes

Year Ended June 30, 19_____
Hybrid University

	Current Year Unrestricted	Restricted	Total	Prior Year Total
Revenues				
Tuition and fees	$2,600,000		$2,600,000	$2,300,000
Federal appropriations	500,000		500,000	500,000
State appropriations	700,000		700,000	700,000
Local appropriations	100,000		100,000	100,000
Federal grants and contracts	20,000	$ 375,000	395,000	350,000
State grants and contracts	10,000	25,000	35,000	200,000
Local grants and contracts	5,000	25,000	30,000	45,000
Private gifts, grants, and contracts	850,000	380,000	1,230,000	1,190,000
Endowment income	325,000	209,000	534,000	500,000
Sales and services of educational activities	190,000		190,000	195,000
Sales and services of auxiliary enterprises	2,200,000		2,200,000	2,100,000
Expired term endowment	40,000		40,000	
Other sources (if any)				
Total current revenues	7,540,000	1,014,000	8,554,000	8,180,000
Expenditures and mandatory transfers				
Educational and general				
Instruction	2,960,000	489,000	3,449,000	3,300,000
Research	100,000	400,000	500,000	650,000
Public service	130,000	25,000	155,000	175,000
Academic support	250,000		250,000	225,000
Student services	200,000		200,000	195,000
Institutional support	450,000		450,000	445,000
Operation and maintenance of plant	220,000		220,000	200,000
Scholarships and fellowships	90,000	100,000	190,000	180,000
Educational and general expenditures	4,400,000	1,014,000	5,414,000	5,370,000
Mandatory transfers for:				
Principal and interest	90,000		90,000	50,000
Renewals and replacements	100,000		100,000	80,000
Loan fund matching grant	2,000		2,000	
Total educational and general	4,592,000	1,014,000	5,606,000	5,500,000
Auxiliary enterprises				
Expenditures	1,830,000		1,830,000	1,730,000
Mandatory transfers for:				
Principal and interest	250,000		250,000	250,000
Renewals and replacements	70,000		70,000	70,000
Total auxiliary enterprises	2,150,000		2,150,000	2,050,000
Total expenditures and mandatory transfers	6,742,000	1,014,000	7,756,000	7,550,000
Other transfers and additions/(deductions)				
Excess of restricted receipts over transfers to revenues		45,000	45,000	40,000
Refunded to grantors		(20,000)	(20,000)	
Unrestricted gifts allocated to other funds	(650,000)		(650,000)	(510,000)
Portion of quasi-endowment gains appropriated	40,000		40,000	
Net increases in fund balances	188,000	25,000	213,000	160,000

See accompanying Summary of Significant Accounting Policies and Notes to Financial Statements

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The significant accounting policies followed by Hybrid University are described below to enhance the usefulness of the financial statements to the reader.

Accrual Basis

The financial statements of Hybrid University have been prepared on the accrual basis except for depreciation accounting as explained in notes 1 and 2 to the financial statements. The Statement of Current Funds Revenues, Expenditures, and Other Changes is a statement of financial activities of current funds related to the current reporting period. It does not purport to present the results of operations or the net income or loss for a period as would a statement of income or a statement of revenues and expenses.

To the extent that current funds are used to finance plant assets, the amounts so provided are accounted for as (1) expenditures, in the case of normal replacement of movable equipment and library books; (2) mandatory transfers, in the case of required provisions for debt amortization and interest and equipment renewal and replacement; and (3) transfers of a nonmandatory nature for all other cases.

Equal Opportunity and Affirmative Action

Answers to the following questions can help the board determine the institution's efforts in equal opportunity and affirmative action.

1. Does the institution have an established equal opportunity policy?

2. Has the institution complied with federal and state regulations governing equal opportunity?

3. Has there been improvement in the relative position of minority group members and women in the institution's faculty and staff? How has performance compared with expectations?

Faculty Effort

Answers to the following questions can help the board determine the institution's policy on faculty effort.

1. Does the institution have a policy on faculty effort describing standard teaching loads, released time available for research, administrative requirements, and so on?

2. Has the board established policies governing consulting activities of its faculty and determined if they are consistent with academic program objectives?

Conflict of Interest

Exhibits D and E are two possible options for the purpose of developing

and maintaining adequate records. Either option can be modified or adapted, with advice of legal counsel, to institutional circumstances and board judgment. Neither form is presented as a perfect device. Boards electing to adopt a version of either form are urged to require each board member to complete and update it annually. Further, the forms should be formally reviewed on a schedule and by an official or officials determined by the board.

For a complete set of guidelines on conflict of interest, see "Guidelines for Policies Affecting Potential Conflicts of Interest" (*AGB Reports*, vol. 21, no. 1, Jan./Feb. 1979), which is available from the Association of Governing Boards. The two forms below are included in that publication.

Exhibit D
Conflict of Interest Questionnaire

(Institution Name)

(Name) (Date)

Office Held (Trustee, Vice President for Administration, Etc.)

1. Are you an officer of director of any corporation with which (institution name) has business dealings? Yes_____ No_____
If the answer to the foregoing question is "yes," please list the names of such corporations, the office held, and the approximate dollar-amount of business involved with the (college or university) last year.

2. Do you, or does any member of your family, have a financial interest in, or receive any remuneration or income from, any business organization with which (institution name) has business dealings? Yes_____ No_____
If the answer to the foregoing question is "yes," please supply the following information:

a. Names of the business organizations in which such interest is held and the person(s) by whom such interest is held:

b. Nature and amount of each such financial interest, remuneration, or income:

3. Did you or any member of your family receive, during the past twelve months, any gifts or loans from any source from which (institution name) buys goods or services or with which (institution name) has significant business dealings? Yes_____ No_____
If the answer to the foregoing question is "yes," list such gifts or loans as follows:

Name of Source	Item	Approximate Value

I certify that the foregoing information is true and complete to the best of my knowledge.

Signature Date

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Exhibit E
Disclosure Letter

Board Secretary (or other designated official)
(Name and address of college or university)

Dear _____:

I have received and read the statement of "Policy on Conflicts of Interest" approved by the board on ___(date)___, and I am in compliance with the policy except as specifically set forth below.

For the information of the (college or university), I am listing on the reverse all of my "associates" as defined, and the position and/or interest which I or members of my family have in each "associate."

Sincerely,

_____

Signature Date

Exceptions
(Note: If there are none, please write "None.")

Associates*

Trustee or Family Member**	**Associate**	**Position and/or Interest**

**An associate of an individual includes any person, trust, organization, or enterprise (of a business nature or otherwise) with respect to which the individual or any member of his or her family (1) is a director, officer, employee, member, partner, or trustee, or (2) has financial interest as described in the board's policy on conflict of interest adopted on (date), or any other interest which enables him or her to exercise control or significantly influence policy.*

***The family of an individual includes his or her spouse, parents, siblings, children, and any other blood relative.*

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Fund Accounting

In order to ensure observance of limitations and restrictions placed on the use of the resources available to the institution, the accounts of the institution are maintained in accordance with the principles of "fund accounting." This is the procedure by which resources for various purposes are classified for accounting and reporting purposes into funds that are in accordance with specified activities or objectives. Separate accounts are maintained for each fund; however, in the accompanying financial statements, funds that have similar characteristics have been combined into fund groups. Accordingly, all financial transactions have been recorded and reported by fund group.

Within each fund group, fund balances restricted by outside sources are so indicated and are distinguished from unrestricted funds allocated to specific purposes by action of the governing board. Externally restricted funds may only be used in accordance with the purposes established by the source of such funds and are in contrast with unrestricted funds over which the governing board retains full control to use in achieving any of its institutional purposes.

Endowment funds are subject to the restrictions of gift instruments requiring in perpetuity that the principal be invested and only the income be utilized. Term endowment funds are similar to endowment funds except that upon the passage of a stated period of time or the occurrence of a particular event, all or part of the principal may be expended. While quasi-endowment funds have been established by the governing board for the same purposes as endowment funds, any portion of quasi-endowment funds may be expended.

All gains and losses arising from the sale, collection, or other disposition of investments and other noncash assets are accounted for in the fund that owned such assets. Ordinary income derived from investments, receivables, and the like is accounted for in the fund owning such assets, except for income derived from investments of endowment and similar funds, which income is accounted for in the fund to which it is restricted or, if unrestricted, as revenues in unrestricted current funds.

All other unrestricted revenue is accounted for in the unrestricted current fund. Restricted gifts, grants, appropriations, endowment income, and other restricted resources are accounted for in the appropriate restricted funds. Restricted current funds are reported as revenues and expenditures when expended for current operating purposes.

Other Significant Accounting Policies

Other significant accounting policies are set forth in the financial statements and the notes thereto.

Glossary

Accreditation: The granting of approval to a college or university by an official review board after the institution has met specific requirements. Institutional accreditation is carried out by regional accrediting associations; program accreditation (for example, music) is carried out by specialized associations (for example, National Association of Schools of Music).

Agency Funds: Resources held by an institution as custodian or fiscal agent for individual students, faculty, staff members, and organizations.

Aging of Receivables: Analysis of individual accounts receivable according to the time elapsed after the date of billing or the due date, usually the former.

Annuity Agreement: An agreement whereby money or other property is made available to an institution on the condition that the institution bind itself to pay periodically to the donor or other designated individuals stipulated amounts, which payments are to terminate at a time specified in the agreement.

Annuity Funds: Funds acquired by an institution subject to annuity agreements (q.v.).

Appropriation: An expenditure authorization with specific limitations as to amount, purpose, and time; a formal advance approval of an expenditure from designated resources available or estimated to be available.

Auxiliary Enterprise: An entity that furnishes a service directly or indirectly to students, faculty, or staff, and charges a fee directly related to, but not necessarily equal to, the cost of the service. The public may be served incidentally by some auxiliary enterprises. The services are essential elements in support of the institution's program, and conceptually should be regarded as self-supporting.

Bequest: Property received through a will; restrictions may or may not attach to use of the property.

Book Value (of Assets): Purchase price of an asset less any accumulated depreciation; in the case of an asset received as a gift, the appraised market value of the asset as of the date donated less any accumulated depreciation.

Budget: A statement of proposed expenditures for a fixed period or for a specific project or program, and the proposed means of financing the expenditures.

Carnegie Classification: A classification of institutions of higher education, first published in 1973 by the Carnegie Commission on Higher Education and revised in 1976 by the successor Carnegie Council on Policy Studies in Higher Education. It groups institutions into the following categories: doctoral-granting (four subgroups), comprehensive universities and colleges (two subgroups), liberal arts colleges (two subgroups), two-year colleges and institutes, professional and other specialized institutions (nine subgroups), and institutions for nontraditional study.

Current Funds: Resources to be expended in the near term and used for operating purposes.

Debt Financing: Acquisition of an asset by borrowing money, thereby creating a liability; typical forms of debt financing are loans and mortgages.

Debt Service: All payments in connection with funds borrowed by an institution: principal payments, interest charges, payments to sinking funds to ensure future principal and interest payments, payment to reserves to ensure proper upkeep and maintenance of the facilities, trustees' service charges, legal expenses, and other items related to indebtedness.

Deferred (or Unearned) Revenue: That portion of receipts for which services have not been completely performed, e.g., food service payments. Until such services are performed in their entirety, that portion of the receipts is considered a liability.

Designated Funds: Unrestricted resources expendable only for purposes designated by the governing board. (Also see *Undesignated Funds*.)

Endowment Funds: Funds which a donor or other outside agency has stipulated, as a condition of the gift, that the principal is to be maintained inviolate and in perpetuity and that only the income from the investments of the fund may be expended.

Endowment Income: Yield, usually in the form of interest and dividends, which occurs as a result of investing the principal of an endowment fund. Capital gains and losses are not a part of endowment income. (Also see *Total Return*.)

Fellowships: Financial assistance to graduate or postgraduate students, based primarily on academic achievement and vocational and professional objectives. Recipients are not required to render service to the institution as a consideration for their aid, nor are they required to repay. (Also see *Scholarships*.)

Full-Time Equivalent (FTE): A means for expressing part-time students or faculty in terms of full-time. The formula is generally based on credit hours;

for example, an institution may define full-time as being 12 credit hours, so a student (or faculty member) taking (or teaching) three credit hours would then be a .25 FTE.

Fund Accounting: A sum of money and other assets constituting a separate accounting entity, created and maintained for a particular purpose and having transactions subject to legal or administrative limitations. Its double-entry accounts are self-balancing, and from there a balance sheet and operating statement may be prepared.

Fund Balance: The difference between assets and liabilities in a fund group (q.v.).

Fund Group: A group of resources having similar purposes; typical fund groups in colleges and universities are current, loan, endowment and similar, annuity and life income, plant, and agency.

Graduate Record Examination (GRE): An examination taken by undergraduates in their senior year as part of the admission requirements for most graduate institutions.

Indirect Costs: Costs that have been incurred for purposes common to a number or all of the specific projects, programs, or activities of an institution, but which cannot be identified and charged directly to such projects, programs, or activities relatively easily with a reasonable degree of accuracy and without an inordinate amount of accounting. Examples include such items as heating, lighting, air conditioning, and janitorial services of buildings, and administrative services such as accounting, purchasing, personnel, and library services.

Internal Auditing: A review of operations within established policy guidelines, which provides managers with reports, conclusions, and recommendations of the results of the review; it is an element of managerial control of measuring and evaluating the effectiveness of such control within the organization.

Life Income Agreement: An agreement whereby money or other property is made available to an institution on the condition that the institution bind itself to pay periodically to the donor or other designated individual(s) the income earned by the assets donated to the institution for the lifetime of the donor or of the designated individual(s).

Life Income Funds: Funds acquired by an institution subject to life income agreements (q.v.).

Loan Funds: Funds to be lent to students, faculty, or staff. When both principal and interest on the loans are lendable, they are included in the Loan Funds group. If only the income from a fund is lendable, the principal is

included in the Endowment and Similar Funds group, while the cumulative income constitutes the loan fund.

Mandatory Transfers: Transfers arising out of (1) binding legal agreements related to financing the educational plant, such as amounts for debt retirement, interest, and required provisions for renewals and replacements of the plant, not financed from other sources, and (2) grant agreements with agencies of the federal government, donors, and other organizations to match gifts and grants to Loan Funds and other funds. (Also see *Nonmandatory Transfers.*)

Nonmandatory Transfers: Transfers to other fund groups made at the discretion of the governing board to serve a variety of objectives, such as additions to loan funds, additions to quasi-endowment funds, general or specific plant additions, voluntary renewals and replacements of plant, and prepayments on debt principal. (Also see *Mandatory Transfers*).

Payout Rate: See *Spending Policy.*

Plant Funds: Funds to be used for constructing, rehabilitating, and acquiring physical properties for institutional purposes; funds already expended for such properties; funds set aside for the renewal and replacement thereof; and funds accumulated for the retirement of indebtedness thereon.

Pooled Investments: Fund assets pooled or consolidated for investment purposes.

Quasi-Endowment Funds: Funds the governing board, rather than a donor or other outside agency, has determined are to be retained and invested. The governing board has the right to decide at any time to expend such funds. Sometimes referred to as funds functioning as endowment.

Reserve: An account that records a portion of the fund balance that is allocated or set aside for some eventuality or future use and is thus not otherwise available.

Restricted Funds: Funds limited to a specific use by outside agencies or persons, as distinguished from funds over which the institution has complete control and freedom concerning use. (Also see *Unrestricted Funds.*)

Retention: The number of students returning to the institution, typically expressed as a percentage, e.g., seniors/original freshman class.

Sabbatical: A leave of absence, often with pay, granted to a professor, generally for a year at a time, for every six or seven years of continuous service. The primary purpose of such leave is for research or other forms of academic pursuit.

Scholarships: Financial assistance to undergraduate students, generally

based on scholastic achievement and/or financial need. Recipients of scholarships are not required to render service or to reimburse the institution in return. (Also see *Fellowships*.)

Sinking Fund: Cash or other assets, and the interest or other income earned thereon, set apart for retiring a debt or protecting an investment in depreciable property.

Spending Policy: In investing for total return (q.v.), the portion of earnings (expressed as a percentage of market value, sometimes called the "payout rate") for current operating purposes, where "earnings" includes the sum of net realized and unrealized appreciation or shrinkage in portfolio value plus yield (dividend and interest income). A prudent spending policy would protect the endowment from loss of purchasing power before appropriating gains.

Sponsored Projects: Projects performed in accordance with the conditions of agreements with government agencies or other outside organizations or persons to conduct activities of a specified scope.

Tenure: Permanence of position, often granted after a specified number of years.

Term Endowment: Funds donors or other outside agencies, by the terms of the instrument of gift, have provided and which are to be released from inviolability to permit all or part of the funds to be expended when a particular event occurs or when a stated period of time has passed. (Also see *Endowment Funds*.)

Total Return: The sum of net realized and unrealized appreciation or shrinkage in portfolio value plus yield (dividend and interest income).

Transfers: Moving assets, liabilities, and balances from one fund group to another. (Also see *Mandatory Transfers* and *Nonmandatory Transfers*.)

True Endowment: See *Endowment Funds*.

Trust: An agreement by which legal title to one's property is held by another party (trustee) for the future benefit of a designated beneficiary or beneficiaries. According to the terms of the agreement, trusts may be revocable or irrevocable.

Undesignated Funds: Unrestricted resources available for any purpose. (Also see *Designated Funds*.)

Unearned (or Deferred) Revenue: (See *Deferred (or Unearned) Revenue*.)

Unrestricted Funds: Resources provided to the institution with no restrictions on their use. (Also see *Restricted Funds*.)

Working Capital: Current fund cash, or current fund assets converted

to cash, that will be used to liquidate current fund liabilities in a normal operating cycle, which is typically one year.

Bibliography

This selected bibliography is provided to assist readers who wish to explore in greater depth some of the issues addressed in the text. For information about these and other AGB and NACUBO publications, please write to the respective associations at the address on the copyright page.

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